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PUBLIC DEBTS

AN ESSAY IN THE SCIENCE OF FINANCE

BY

HENRY C. ADAMS, PH. D.
OF THE UNIVERSITY OF MICHIGAN, AND CORNELL UNIVERSITY

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1890

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TO
MR. FRANCIS WHITE,
OF BALTIMORE,
WITH THE SINCERE REGARDS OF
THE AUTHOR.

P R E F A C E.

It is the purpose of this treatise upon Public Debts to portray the principles which underlie the use of public credit. The essay is neither statistical nor historical, although it relies upon statistics and makes frequent appeals to history. In one respect it differs from works upon the same subject by German or French writers, for it recognizes a distinction between National Deficit Financiering and Local Deficit Financiering, and lays down rules for the latter not in complete harmony with rules applicable to the former. This peculiarity in structure was imposed upon the essay by the fact that, being addressed to Americans, it was obliged to conform to the characteristic features of American public law.

The author desires to make public recognition of the assistance rendered to him by the late Mr. Raphael A. Bayley, of the Department of Warrants in the United States Treasury, in placing at his disposal certain manuscripts upon questions pertaining to public indebtedness. He also desires to acknowledge the influence of M. Leroy-Beaulieu's masterly work upon the Science of Finance in giving shape to some of the arguments found in the following pages.

ANN ARBOR, MICH., January, 1887.

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PART I.

PUBLIC BORROWING AS A FINANCIAL
POLICY.

PART I.

PUBLIC BORROWING AS A FINANCIAL POLICY.

CHAPTER I.

MODERN PUBLIC DEBTS.

THE civilized governments of the present day are resting under a burden of indebtedness computed at \$27,000,000,000. This sum, which does not include local obligations of any sort, constitutes a mortgage of \$722 upon each square mile of territory over which the burdened governments extend their jurisdiction, and shows a per capita indebtedness of \$23 upon their subjects. The total amount of national obligations is equal to seven times the aggregate annual revenue of the indebted states. At the liberal estimate of \$1.50 per day, the payment of accruing interest, computed at 5 per cent, would demand the continuous labor of three millions of men. Should the people of the United States contract to pay the principal of the world's debt, their engagement would call for the appropriation of a sum equal to the total gross product of their industry for three years; or, if annual profits alone were devoted to this purpose, they would be enslaved by their contract for the greater part of a generation.

But it is not alone the magnitude of this constant drain upon the product of current industry that invites our attention to a study of public debts; their recent appearance suggests many questions of equal importance. Previous to

the present century, England and Holland were the only countries that had learned by experience the weight of national obligations ; but at the present time the phenomenon of public debts is almost universal, and there are many peoples that rival England in the taxes paid for their support. The French debt, capitalized at 5 per cent, is equal to the sum of \$3,900,000,000 ; the Italian debt, estimated in the same manner, amounts to \$2,160,000,000 ; while that of Spain is \$1,250,000,000 ; that of Austria-Hungary is \$2,000,000,000 ; that of Russia is \$2,420,000,000. That this policy of resorting to public credit as a source of revenue did not become general till after 1848 may be seen from the figures presented in the following table :

Table showing the Growth of Public Debts for Stated Years.

A. D. ¹	Capital sums owed.	Character of periods.
1714.....	\$1,500,000,000	Chiefly peace.
1798.....	2,500,000,000	War.
1820.....	7,750,000,000	Peace.
1848.....	8,650,000,000	Armament.
1862.....	18,750,000,000	War.
1872.....	28,026,000,000	Armament and national improvement.
1882.....	26,970,000,000	

A glance at this table shows that modern governments do not pay running expenses. The extension of indebtedness, from 1798 to 1820, was in large part due to the creation of the English debt during the Napoleonic wars. From 1820 to 1848 there was but a limited appeal to credit by the leading nations of the world, although neither Austria nor France succeeded in fully meeting current expenditure with clear income. But about this time a decided change seems to have made its appearance. Napoleon III drew France into a most reckless system of financing. Between 1862 and 1872 there were certain great wars which added enormous sums to the debts of the world. To quote from Mr. Nash :

¹ Authority for dates previous to 1862 is Mr. R. Dudley Baxter ; for dates 1862 and subsequent, Mr. Robert Lucas Nash.

The United States Civil War cost the victors no less than £450,000,000, while the Austro-German War added £60,000,000; the Paraguayan War, £40,000,000; and, lastly, the Franco-German War, £390,000,000 to the sum total of National burdens.¹

Never before has such free use been made of public credit. The ten years following 1872 witnessed several expensive conflicts between some of the smaller states, while many of the British colonies, as well as some of the European powers of the first class, adopted a line of domestic financing that resulted in greatly extending the list of public bonds. The fact is, that since 1848 there has been an annual average deficit in the public accounts of the world of over \$530,000,000. The constancy of this deficit shows a confirmed policy on the part of governments. Such management of public treasuries (whether mismanagement or not is a question for later discussion) was unknown to earlier financiers. Both the extent to which borrowing is carried and the carelessness with which it is regarded shows that a new factor has been introduced into public life.

This impression will be confirmed if we notice the large number of states that have recently become acquainted with the use of sovereign credit. In 1862 there were quoted upon the London Stock Exchange foreign stocks to the amount of £697,830,000; while the quotations of ten years later show the same class of securities to have expanded to the enormous figure of £2,430,000,000. At the present time over one hundred states that possess practical sovereignty for debt purposes offer their bonds to the choice of an English investor, and if to this number were added the obligations of *quasi* sovereignties, the London market would show over one hundred and fifty sorts of public securities. There are here found the bonds of China, Japan, Persia, Siam, Egypt, Liberia, Orange Free States, Zanzibar, besides many other peoples of the Old World. The South American states are nearly all represented, while the islands of the tropics and

¹ "Penn on the Funds." Introduction, p. v.

the ice-banks of the Arctic have also learned the lesson that capital can be had for a promise to pay.

It is all the more difficult to understand this new method of financiering, because it has made its appearance while wealth has been rapidly increasing. The world is daily growing rich. Nature yields her forces with ever-increasing willingness to serve the industrial purposes of men ; and yet, notwithstanding increased opulence, the governments of the world are plunging headlong into debt. How are these facts to be explained ? From what conjunction of circumstances did they spring ? What are the political, the social, and the industrial tendencies bound up in this prevalent custom of drawing bills on the future ? And of more importance than all else, what is the future that this method of financiering is preparing for the world ?

It is truly a difficult task to read aright the tendencies of one's own day. Those changes that draw the deep lines of history, and which in the perspective of an hundred years stand forth in clear relief, appear to him whose life is touched by them as altogether wanting in significance. Yet it is possible, by careful analysis, to separate the ephemeral from the permanent, and this task must be undertaken for the question now claiming our attention. For, until we can understand the facts pertaining to the history of debts, we shall be unable to decide whether this new policy of treasury management is a symptom of health or of disease in the body politic, nor can we with any satisfaction pass judgment upon questions of a technical nature. It then becomes our first duty to understand the facts, and to learn what there is in the social and industrial life of the present which permits this new theory of financiering to make its way with such ease.

It requires but a slight study of modern public debts to perceive that an explanation of their origin and development can not be the same for all peoples. With some the habit of borrowing money seems to be indigenous, having sprung naturally from the political and social relations of their com-

plex civilization ; but with others the growth of public debts is largely the result of imitation, or of foreign interference. There can be no question as to the proper order of study. We must first consider the development of the borrowing system among those peoples with whom it is the natural outgrowth of peculiar relations.

When a responsible government desires to borrow money it must divest itself for the time being of all sovereign powers, and come before its subjects as a private corporation. It must bargain with those who have money to lend, and satisfy them as to questions of payment and security. From this it follows that a successful attempt to establish the borrowing system implies two things :

1. That a money market should have been previously established.
2. That there should be found, either in the structure of the government or in its actual management, a guarantee against repudiation.

Viewed in this light, the funding system seems to be capable of wide acceptance only among peoples whose labor is of a high grade of efficiency, and who have developed for themselves representative government. But the conditions here suggested call for separate treatment.

A market was originally a place for buying and selling, "but the word has been generalized, so as to mean any body of persons who are in intimate business relations and carry on extensive transactions in any commodity."¹ The presence of a market among a people shows that they are accustomed to deal in the article sold, and that their industry supplies those things that may serve as purchasing commodities. Upon the money market the article sold is credits ; the purchasing commodity, on the other hand, is free capital. The existence of a money market, therefore, implies quite a number of facts pertinent to our general question. It implies, first of all, a somewhat advanced state of industrial

¹ Jevons' "Theory of Political Economy," p. 84.

development, otherwise no capital would exist for the purchase of credits offered. It implies, also, that some machinery must have been provided for gathering together the capital of the country. But of more importance is the fact that a money market declares the prevalence of the commercial idea in business. It implies what the Socialists call "capitalistic production."¹ The idea of satisfying wants as a motive to industry has given way to a desire for riches. Money has come to be used as capital, and the conception of profit is ever present in all business transactions.² A money market, then, is a feature of society peculiar to peoples of a somewhat intense commercial life, and it is only among commercial peoples that the debt system can naturally arise.

Turning, now, to the second condition for the successful establishment of the borrowing system, let us inquire why men with money are so willing to purchase public bonds. What is the basis of that confidence which they repose in governments? As bearing upon this question, it is a peculiar, and at the same time a significant, fact that borrowing has never been widely practised except by republics or by peoples possessing some form of constitutional government. The Republic of Venice is usually credited with having inaugurated the policy of public loans. Holland, in fighting for her freedom, resorted to borrowing so freely that in 1714 her citizens were bearing a per capita charge of nearly \$8 for the support of her debt. William III, who founded the debt of England, was the successful leader of the popular party against the usurpation of personal rule. Instances of

¹ One at all familiar with the writings of Karl Marx will understand at once what is meant by this expression. Cf. "Le Capital." The title of the first book is, "Développement de la Production Capitaliste." More available, though less acute, is Hyndman's "Historical Basis of Socialism in England." Cf. Ch. III, which treats of the rise of the middle class.

² In speaking of the consequences of the breaking up of the mediæval social system, Cunningham says: "One result of all these various changes was the appearance of a new factor in the economic sphere: we now for the first time hear of *capital*, in the modern sense of the word." Cf. "Growth of English Industry and Commerce," p. 249.

loans among other peoples, as, for example, the loans of France or of Spain, did not constitute a free-will transfer of capital to the state, and for that reason differed from the borrowing of modern times.

As the matter presents itself to my own mind, the true explanation of this trust, so generally reposed in modern governments, is found in the peculiar development of constitutionalism during the past two centuries. The broad theory of constitutional liberty is that the people have the right to govern themselves; but the historical fact is that, in the attempt to realize this theory, the actual control of public affairs has fallen into the hands of those who possess property.

It follows from this that when property-owners lend to the government, they lend to a corporation controlled by themselves. The confidence which they repose in government does not rest upon sentiment or patriotism, nor does it show greater integrity on the part of people now than in former times; its simple interpretation is that the possessing classes have made their conception of rights and liberty the efficient idea of modern times, and that in some way the moneyed interest has captured the machinery of government. Our modern political society is properly characterized as commercial constitutionalism, and out of this fact arises such guarantee as exists that moneys borrowed by governments will be repaid. If this be accepted as correct, it is easy to see why any extended use of public credit was not possible, outside of England, until the present century; and why, so far as European states are concerned, the funding system did not assume importance until about 1848, for it was not till after the events of that year that the commercial spirit assumed control in public affairs.

Should one desire to test the accuracy of this interpretation, he can not do better than study the origin and development of the debt of England. The founder of this debt was William III, who was essentially a mercantile monarch, and who, upon coming to the throne, found in England a

mercantile people.¹ The idea that swayed public opinion in the eighteenth century is most clearly traced in the colonial policy. To this all political thought was subordinated ; in its interests all foreign policy was directed. At home there was the forming of companies, abroad there was the founding of plantations. The domestic interests of Englishmen were absorbed in the greater interest of England. The old permanent relations of the sixteenth century were broken up, and the tendency toward that disintegration which we notice in our own times had begun to make its appearance. The conception of profit familiarized itself to men of this century as the true test of success in business ventures. Steady industry for the sake of gaining those things that satisfy material desires was giving way before enterprises inspired by the hope of acquiring great wealth. England was the path-breaking nation in this industrial revolution, nor did continental peoples generally discern the true significance of her policy until the present century.

At the same time that domestic affairs were being directed in the interest of foreign trade, the political thought of England was setting strongly against irresponsible political power. The disintegration of feudal society invited here, as elsewhere, the centralization of authority in the hands of the strongest, but English history differs from that of most peoples in one important particular. The people of England never acquiesced in the establishment of an irresponsible monarchy, and, upon the failure of the Tudor and the Stuart experiments, it was found that this country had made appreciable advance in the development of constitutional ideas. There arose a demand for self-government in fact as well as in name, and, so far as the landed and mercantile classes were concerned, such a government was established. The fruit of this victory of aristocracy over monarchy was the

¹ "The age of chivalry passed away when the Puritans defeated the Cavaliers. The establishment of standing armies, and the creation of a national debt, went to show that *money*, not knighthood, or knight's service, gave force to law."—"Landholding in England," by Joseph Fisher, p. 89.

declaration of rights granted by William III. It appears then a coincidence with a reason that this monarch, who extended political freedom to the possessing classes, should also have founded the English debt.

Turning, now, from the establishment of the English debt to consider the period of its extension, we discover no reason for modifying our general conclusions. This extension took place during the last quarter of the eighteenth century, and was occasioned by the American and Napoleonic wars. We can not hope to understand this period without noticing the great inventions which revolutionized textile industries. The immediate effect of these inventions was to raise labor to a high grade of efficiency, and to create in English hands a large surplus of manufactured products; but since the commerce of England permitted her to dispose of this surplus, the final result was a great increase in national wealth, which, in its turn, served as the basis for a new class in society, and for the rise of a new political interest. It was in the presence of such conditions that the government found itself in need of funds to carry on its wars, and it became of much importance to those who were charged with the conduct of public affairs, that the manufacturing class should be favorably disposed. In this manner there was provided an opportunity for the new interest to acquire political power, an opportunity of which it was not slow to avail itself. It is not necessary to proceed farther with this analysis. It is readily seen that all the conditions for public borrowing were even more fully realized in the latter part of the eighteenth century than when the debt of England was first established. The money market, and all that it implies, had become perfectly developed, while the practical control over public affairs lay largely in the hands of the patrons of the state. Indeed, the relation that existed between the government and those who loaned it money during the Napoleonic wars, is a striking illustration of the political basis of public borrowing; for the fact is that the borrowing body and the lending body were separate only as legal personages.

The foregoing analysis has disclosed to us the general conditions from which it is possible for the borrowing system to take its rise, but the political necessities for borrowing must likewise be discovered before the full significance of credit financing in modern life may be portrayed. It is claimed by many writers of recognized standing that an extension of public duties, and in consequence an increase of public expenditures, attends every advancing step of civilization. This is stated as a permanent law of progress, but does not appear to me to be worthy such a name. Still the recognition of this law is pertinent to our present purpose, for while it can not be brought into harmony with all sorts of social advancement, it does apply to that peculiar advance in civilization known as nineteenth century progress. It is true that the present century has witnessed a great extension of public expenditure, and that this expenditure has been the necessary consequence of what is termed modern civilization.

It lies, then, within the range of our study to inquire respecting the facts of public expenditure, so far as may be necessary to discover the prevalent tendency in treasury management. In the table that follows, there is presented the total and the per capita expenditure of the six great European peoples and of the United States. It is believed that the figures are sufficiently accurate to serve the purpose for which they are presented, yet it must be admitted that the task of providing comparative statistics, which shall in all respects be satisfactory, is an extremely difficult one—a difficulty that arises not so much from the paucity of data as from the diversity which exists in the various systems of public accounts.

It requires but a glance at the rapid growth of per capita expenditure to perceive that the increase in the cost of government bears no constant relation to the increase in population. Consider, for example, the figures of the French budget. In 1840, the government of France demanded from each subject the sum of \$6.98, while at the present time the per capita levy amounts to nearly three times that

Table showing Certain Flucts of Expenditure for the Seven Leading Nations of the World.¹

UNITED STATES.		AUSTRALIA.		ITALY.		PRUSSIA.		ENGLAND.		FRANCE.		A. D.	
Per capita expenditure.	Total expenditure, in millions of dollars.	Per capita expenditure.	Total expenditure, in millions of dollars.	Per capita expenditure.	Total expenditure, in millions of dollars.	Per capita expenditure.	Total expenditure, in millions of dollars.	Per capita expenditure.	Total expenditure, in millions of dollars.	Per capita expenditure.	Total expenditure, in millions of dollars.	Per capita expenditure.	Total expenditure, in millions of dollars.
1.60	27.8	4.60	27.8	2.90	27.4	5.16	27.4	1.40	26.0	8.00	8.00	5.34	267.0
2.00	37.8	4.80	37.8	3.16	37.4	6.39	37.4	2.45	36.0	8.27	8.27	5.34	367.0
2.45	47.4	5.27	47.4	4.80	47.0	7.84	47.0	3.00	45.0	8.54	8.54	5.34	467.0
3.00	57.4	5.97	57.4	5.39	57.0	10.23	57.0	2.00	55.0	8.84	8.84	5.34	567.0
3.45	67.4	6.39	67.4	6.80	67.0	12.23	67.0	1.40	65.0	9.14	9.14	5.34	677.0
4.00	77.4	7.84	77.4	7.39	77.0	14.23	77.0	1.40	75.0	9.44	9.44	5.34	787.0
4.39	87.4	8.54	87.4	8.80	87.0	16.23	87.0	1.40	85.0	9.74	9.74	5.34	897.0
4.80	97.4	9.14	97.4	9.39	97.0	18.23	97.0	1.40	95.0	10.04	10.04	5.34	997.0
5.16	107.4	9.84	107.4	10.80	107.0	20.23	107.0	1.40	105.0	10.34	10.34	5.34	1117.0
5.34	117.4	10.23	117.4	11.80	117.0	22.23	117.0	1.40	115.0	10.64	10.64	5.34	1217.0
5.34	127.4	10.64	127.4	12.80	127.0	24.23	127.0	1.40	125.0	11.04	11.04	5.34	1317.0
5.34	137.4	11.04	137.4	13.80	137.0	26.23	137.0	1.40	135.0	11.34	11.34	5.34	1417.0
5.34	147.4	11.34	147.4	14.80	147.0	28.23	147.0	1.40	145.0	11.64	11.64	5.34	1517.0
5.34	157.4	11.64	157.4	15.80	157.0	30.23	157.0	1.40	155.0	12.04	12.04	5.34	1617.0
5.34	167.4	12.04	167.4	16.80	167.0	32.23	167.0	1.40	165.0	12.34	12.34	5.34	1717.0
5.34	177.4	12.34	177.4	17.80	177.0	34.23	177.0	1.40	175.0	12.64	12.64	5.34	1817.0
5.34	187.4	12.64	187.4	18.80	187.0	36.23	187.0	1.40	185.0	13.04	13.04	5.34	1917.0
5.34	197.4	13.04	197.4	19.80	197.0	38.23	197.0	1.40	195.0	13.34	13.34	5.34	2017.0
5.34	207.4	13.34	207.4	20.80	207.0	40.23	207.0	1.40	205.0	13.64	13.64	5.34	2117.0
5.34	217.4	13.64	217.4	21.80	217.0	42.23	217.0	1.40	215.0	14.04	14.04	5.34	2217.0
5.34	227.4	14.04	227.4	22.80	227.0	44.23	227.0	1.40	225.0	14.34	14.34	5.34	2317.0
5.34	237.4	14.34	237.4	23.80	237.0	46.23	237.0	1.40	235.0	14.64	14.64	5.34	2417.0
5.34	247.4	14.64	247.4	24.80	247.0	48.23	247.0	1.40	245.0	15.04	15.04	5.34	2517.0
5.34	257.4	15.04	257.4	25.80	257.0	50.23	257.0	1.40	255.0	15.34	15.34	5.34	2617.0
5.34	267.4	15.34	267.4	26.80	267.0	52.23	267.0	1.40	265.0	15.64	15.64	5.34	2717.0
5.34	277.4	15.64	277.4	27.80	277.0	54.23	277.0	1.40	275.0	16.04	16.04	5.34	2817.0
5.34	287.4	16.04	287.4	28.80	287.0	56.23	287.0	1.40	285.0	16.34	16.34	5.34	2917.0
5.34	297.4	16.34	297.4	29.80	297.0	58.23	297.0	1.40	295.0	16.64	16.64	5.34	3017.0
5.34	307.4	16.64	307.4	30.80	307.0	60.23	307.0	1.40	305.0	17.04	17.04	5.34	3117.0
5.34	317.4	17.04	317.4	31.80	317.0	62.23	317.0	1.40	315.0	17.34	17.34	5.34	3217.0
5.34	327.4	17.34	327.4	32.80	327.0	64.23	327.0	1.40	325.0	17.64	17.64	5.34	3317.0
5.34	337.4	17.64	337.4	33.80	337.0	66.23	337.0	1.40	335.0	18.04	18.04	5.34	3417.0
5.34	347.4	18.04	347.4	34.80	347.0	68.23	347.0	1.40	345.0	18.34	18.34	5.34	3517.0
5.34	357.4	18.34	357.4	35.80	357.0	70.23	357.0	1.40	355.0	18.64	18.64	5.34	3617.0
5.34	367.4	18.64	367.4	36.80	367.0	72.23	367.0	1.40	365.0	19.04	19.04	5.34	3717.0
5.34	377.4	19.04	377.4	37.80	377.0	74.23	377.0	1.40	375.0	19.34	19.34	5.34	3817.0
5.34	387.4	19.34	387.4	38.80	387.0	76.23	387.0	1.40	385.0	19.64	19.64	5.34	3917.0
5.34	397.4	19.64	397.4	39.80	397.0	78.23	397.0	1.40	395.0	20.04	20.04	5.34	4017.0
5.34	407.4	20.04	407.4	40.80	407.0	80.23	407.0	1.40	405.0	20.34	20.34	5.34	4117.0

¹ It may be proper to caution the reader against using the data here presented for the purposes of comparing the financial standing of the various states. Such a comparison can not be instituted except on the basis of an exhaustive study of the several financial systems. The same tendency is observed in Prussia, though not in so marked a degree; but it should be remembered that the period to which our table draws attention witnessed the expansion of territorial jurisdiction, and a rapid increase of population, by Prussian conquest. It should be remembered also that a smaller proportion of total expenditure finds its way into the national accounts in Prussia than in France. The English are the only people whose budget does not show a decided tendency toward expansion. But it must be noticed that England passed through the experience of rapidly increasing expenditure before the period contemplated by this table, and, what is of more importance, that many duties are imposed upon the local governments which in France are supported out of the central treasury. The same is true of the United States. The national budget shows national expenditure only,

and in the figures presented in the table the surplus over ordinary expenditures annually appropriated to the payment of the public debt has been excluded. If to these sums were added the cost of State, county, and city governments, the total expenditure for public purposes in this country would approximate \$700,000,000, being a payment of \$12.75 per capita.

How may this tendency toward an increase of public expenditure be explained? Is it proof that modern states are less economically administered than formerly, or does it indicate that their duties have been extended? An answer to these questions will disclose the purposes for which such free use has been made of public credit.

A candid inquiry into the administration of modern governments permits one to say, in the first place, that public extravagance does not adequately explain constantly growing treasury deficits. There have been without doubt many instances of unwarranted expenditure. The government of France, since 1876, controlled by factions rather than parties, and administered in connection with a most corrupt civil service, is open to the charge of criminal extravagance. Nor is the United States, since 1868, above criticism in this regard. In Egypt, also, as well as in many other countries, where cabinets and budgets are of foreign importation rather than domestic growth, the administration of finances may be justly censured. Still, when all is said that may be truly said, public extravagance does not adequately account for the rapid expansion of the demands of modern governments. We must look deeper into the national purpose which now controls public sentiment for the explanation of the facts here disclosed.

A careful analysis of modern life will disclose two ideas, distinct in their origin yet harmonious in their working, to which all political thought of the present conforms. The first of these is nationality, the second socialism; and so pertinent are they to the question in hand that it will be worth our while to consider them at some length.

There can be no doubt as to the meaning of the word nationality, nor can one for a moment question the prevalence and power of this idea. It supplies the thread that runs through all Prussian history; it is the inspiration of French policy; it is the essence of Italian unity; it is the bulwark of the protective system wherever that system exists. Even Englishmen are beginning to agitate for a "Greater England," while in the United States there is no lack of that national pride which, upon occasion, would lead this people to sacrifices the most extreme.

For countries that find their defense from foreign interference in their territorial situation, the influence of the national spirit can not be distinctly traced in public appropriations. In the United States, for example, the pernicious workings of nationality do not extend farther than this—that revenue machinery is used for other than revenue purposes, and some millions are annually paid on account of tariff laws which never find their way into the public treasury. Other people are not, however, so fortunately situated. The boundaries of European countries have been determined by military chieftains. Territory is held by the strongest nation so long as it continues to be the strongest, and every government lives in constant dread lest the least display of military weakness should serve as an occasion for the re-opening of old disputes. The consequence is that Europe has become an armed camp; new fortifications mark new acquisitions; railroads are built for military rather than commercial purposes; and large sums of money, as also the services of large numbers of men, are annually sacrificed to the spirit of nationality.

In the table immediately following, I have endeavored to bring together in compact form a few facts designed to illustrate the tendency with respect to modern armaments. In the first column, under each state considered, will be found the annual expenditure for army and navy for the years ending each decade since 1850. These figures represent the cost of the standing establishment, but do not include war

pensions or war debts, which properly should be reckoned in the military chapter of the budget. In the second column is presented the peace footing of the armies. No attempt has been made to collate these figures so that they may serve for comparative purposes, and, indeed, that would be somewhat difficult, owing to the different methods of army organization. In Russia, for example, the civil police are reckoned as part of the standing army, while it is well known that the word "reserve" in England means quite a different thing from what is suggested by its use in France or in Germany. The true interpretation of this table appears when its figures are read from top to bottom. The remaining columns express in another manner the facts already given respecting the standing army; the one estimates the army upon the basis of each one thousand of the inhabitants, the other upon the basis of territory over which jurisdiction is maintained.

Table showing Modern Tendency toward Armament.

A. D.	Peace footing of the army.	Annual expenditure for army & navy, in millions of dollars.	Army per 1,000 inhabitants.	A. D.	Peace footing of the army.	Annual expenditure for army & navy, in millions of dollars.	Army per 1,000 inhabitants.	Army per square mile.
England				Prussia				
1850.	102,000	75·5	3·7	1850.	122,000	18·0	7·6	1·2
1860.	145,000	148·7	5·0	1860.	212,000	24·0	11·7	2·0
1870.	135,000	112·7	4·8	1878. ¹	402,000	74·0	12·4	2·2
1880.	107,000	127·2	8·1	1880.	402,000	87·0	9·9	1·9
France				Russia				
1850.	394,000	99·2	10·76	1850.	890,000	6·0	6·4	.047
1860.	890,000	94·0	10·54	1860.	557,000	81·8	7·9	.066
1870.	404,000	111·9	10·68	1870.	765,000	181·9	9·8	.093
1880.	502,000	160·0	18·58	1880.	884,000	174·5	10·4	.17

If the figures of the table are even approximately correct they must be accepted as satisfactory evidence that the spirit of nationality is responsible for having largely extended public expenditure. And if we look a little deeper into the matter, we shall see that much of this expenditure on ac-

¹ German Empire.

count of the military service is of such a sort as to lead naturally to an accumulation of public debt. The implements of destruction, as also the armaments of defense, for battle on land as well as on sea, have been greatly changed since 1848 ; a fact due to the continuous development of the science of war as a department of mechanics. But every change in military equipment has demanded an immediate expenditure of such large sums of money that no financier could wisely meet the demand by a single tax ; and a loan to secure money for this purpose would scarcely be placed, before some new improvement in the art of devastation would call for new expenditure. In this manner new debts would be piled upon the old. This is the explanation of a considerable part of modern indebtedness. It finds its purpose in intense nationality, and its occasion in the development of military science.

What, now, can be said of the spirit of socialism in its influence upon modern expenditures ? The word is, of course, used in its broadest sense. It should not suggest any peculiar form of industrial organization, but bring rather to mind the thought of extended state functions.¹ The content of socialism is a set of ideas that stand opposed to individualism. Whenever governments disregard the rule of *laissez faire*, and assume functions that extend beyond "the protection of persons and property from violence and fraud," they turn their steps toward socialism. Thus the support of public schools is socialistic. Factory acts, compulsory insurance acts, and laborers' dwellings acts are commonly regarded as socialistic. The support of public parks, of Sunday amusements, of theatres and operas, as also the administration of the post-office, of railroads, of express, and of telegraph, are in harmony with the theory of State Socialism.

It would unnecessarily encumber our study to trace in de-

¹ This use of the word is a concession to popular expression. The fundamental conception that underlies socialism is the assertion of certain suppressed rights in favor of those who possess no property except property in themselves. The programme for realizing these rights is but an accidental accessory to socialism. Mr. Rae, in his "Contemporary Socialism," devotes the first part of his introductory chapter to the presentation of this fact.

tail the influence of modern socialism upon the development of modern budgets, still a few facts may be appropriately presented for purpose of illustration. There is perhaps no chapter of financial history which shows so clearly the workings of this sentiment as that which pertains to the administrations of the French treasury since 1868. This short chapter divides itself into two parts, the first covering the period from 1868 to 1876, the second from 1876 to the present time. The financial disturbances introduced during this first period are due to the disasters of war, to the payment of an indemnity of five millards of francs to Germany, and to the reorganization of the French army. In consequence of these extraordinary expenditures, the financial demands of the government were greatly increased ; but the people assented without complaint to the burdens thus imposed, for they regarded them as essential to the maintenance of the honor of France. By the year 1876 ordinary income had been forced up to the demands of expenditure, and the accounts of that year showed a surplus in the treasury. From this it appears that a comparison of the budget of 1876 with that of 1869 will disclose the extent to which the financial administration of the country had been affected by the disastrous war of 1870.

But with the year 1876 new demands began to assert themselves, the influence of which is easily seen in the increase of public expenditure. The disbursements of this year, placed by the side of those of 1869, show that expenditures had increased 526,000,000 francs. The figures pertaining to those three years are presented in the following table :

Expenditure of France, expressed in Millions of Francs.¹

A. D.	Ordinary.	Extraordinary.	Total.
1869.....	1688·3	215·9	1904·2
1876.....	2680·2	380·5	3030·7
1883.....	8027·8	529·1	8556·9

¹ "Étude sur la Gestion Financière en France depuis 1871." Par Octave Noël, 1884, p. 60.

It appears from the above that the average annual increase in fiscal demands for the seven years preceding 1883 amounts to 75,000,000 francs, or, if ordinary expenditures only be taken into the account, these demands have grown at the rate of 50,000,000 francs each year. "This difference," says the writer, upon whose authority the figures are taken, "is entirely due to new tendencies introduced into administrative policies, to the demand, now become irresistible, of making the government inspire and undertake all those lines of activity presenting a character of collective utility." There is much truth in this statement, as may be seen by tracing the increase in the cost of government to the items of appropriation, as shown in the following exhibit :

Ordinary and Extraordinary Expenses of the Civil Departments from 1869 to 1883, in millions of Francs.¹

DEPARTMENTS.	1869.	1876.	1883.	From 1869 to 1883.		From 1876 to 1883.	
				Increase.	Decrease.	Increase.	Decrease.
Finances.....	20·4	24·8	19·6	....	·8	....	4·7
Justice.....	86·1	83·0	85·9	....	·2	·9	....
Foreign affairs.....	13·8	11·3	14·3	·5	....	3·0	....
Interior.....	60·0	98·8	68·8	8·8	....	....	29·5
Post and telegraph.....	....	....	9·9	....	....	9·9	....
Public instruction.....	25·5	39·7	183·8	108·3	....	94·1	....
Culture.....	48·9	58·9	58·0	4·1	....	....	·9
Fine arts.....	12·4	7·1	16·7	4·3	....	9·6	....
Agriculture and commerce.....	12·2	18·4	46·6	20·9	....	14·7	....
Public works.....	113·3	215·5	579·6	466·3	....	864·1	....
General government of Algeria.	15·4	28·4	....	....	....	....	....
Total.....	858·0	531·9	978·2	612·2	1·0	496·8	35·1
				Increase, 612·2		Increase, 461·2	

It will be noticed, in the first place, that this table does not include military expenditure, but considers only the cost entailed by the civil departments. The important fact presented is that the total disbursements for the administration of civil affairs has increased 612,200,000 francs since the year 1869; and that this increase is traceable to appropria-

¹ "Etude sur la Gestion Financière en France depuis 1871," p. 86.

tions for public works, public instruction, and for the departments of agriculture and commerce. If now those figures which pertain to the entire period be compared with those presented in the sixth and seventh columns, which portray changes in the budget since 1876, it will be observed that 461,200,000 francs out of a total of 612,200,000 francs is due to very recent extensions of administrative functions. In 1870 the state demanded but \$10.81 from each citizen of France; at present the per capita demand is \$17, but it shows an ignorance of facts to charge the entire amount of this increase in public burdens to the disasters of the Franco-Prussian War. A new principle has made its appearance in the control of the French budget, which, for want of a better name, has been termed the spirit of socialism. Nothing is at present said in criticism of this principle. It may be evidence of high statesmanship to employ the revenue machinery of a state to carry on public works.

I have referred thus in detail to the administration of finances in France merely for the purpose of illustrating a general tendency. Many other governments, especially those of the British colonies, have borrowed freely for public improvements of all sorts, and, when the question of local indebtedness shall claim our attention, it will be observed that municipal governments are not at all backward in employing their revenue machinery and their credit for industrial purposes. So important does Mr. Nash regard this tendency that, in his treatise upon the public funds, he has endeavored to separate those public stocks resting upon taxes from those that rest upon public works. Such a task is of course attended with great difficulty, but, as the result of his estimate, it appears that over \$2,000,000,000 of stocks represent productive property under the control of indebted governments.¹

I have thus endeavored to explain the rise and extension of credit financing among those peoples for whom it is a natural growth. But, if we include in our view the entire

¹ "Fenn on the Funds," 1883. Introduction, p. xvii.

list of outstanding obligations, we shall discover that the funding system has been adopted under conditions not contemplated by the foregoing explanation. There are many peoples for whom constitutional ideas are wholly foreign, who fail to understand modern industrial methods or modern ideas of rights, but who nevertheless make frequent appeals to sovereign credit to replenish an empty treasury. What new meaning attaches to credit financing under such conditions? Without entering into details, it may be said that, wherever this form of treasury management is not indigenous, it is traceable either to conscious imitation of Europeans, or to military or diplomatic interference on the part of foreigners. The industries of such peoples may not be sufficiently far advanced to supply a fund of free capital from which to fill their own loan; they are consequently obliged to appeal to their more wealthy neighbors. Having no well-defined market of their own, they appear as borrowers in the markets of London or Paris. This implies that commercial relations have been already established, and that the people who borrow are producers of some commodity desired by those who lend. From this it appears that international borrowing is but a phase of international trade. It shows that commerce between widely separated territories, commonly regarded as an exchange of goods for goods, may, like domestic trade, resolve itself into a sale of goods for credits.

But the important feature of public borrowing by governments of this class makes its appearance when we inquire what guarantee a foreign creditor has against repudiation? What, for example, is the basis of that confidence entertained by a citizen of England that, in lending to Peru or Victoria, he is making a safe investment? This question, however, has not been introduced for the sake of giving an immediate reply, but to bring clearly into view an inherent difference between domestic and foreign borrowing. Its consideration will claim a large share of our attention in the following chapter, which treats of the political tendencies of public debts.

CHAPTER II.

POLITICAL TENDENCIES OF PUBLIC DEBTS.

It seems necessary to recognize the funding system as an established fact. Not only among the great powers has it made its appearance, but those nations wanting in every essential element of strength have accepted it with equal willingness. Evolved from the same conditions that have given form to modern history, it stands as an essential part of modern life. But in the development of society, every established fact comes itself to be the center of new influences, which, in their turn, give direction to further growth. We may, therefore, fitly inquire what influence this new policy of financial control is likely to exert upon the future development of society. The study presented by this inquiry falls naturally into three parts—calling attention to the political, the social, and the industrial workings of deficit financing. The present chapter confines itself to a consideration of the first of these classes of influences, and undertakes to discover the political tendencies bound up in the use of public credit as a source of revenue.

The most obvious, as perhaps the most serious, of the political tendencies that accompany credit financing, is found in the relation it bears to constitutional government. Its workings in this regard may be very shortly and very definitely stated. The funding system stands opposed to the full realization of self-government. This is not at all difficult to understand. As self-government was secured through a struggle for mastery over the public purse, so must it be

maintained through the exercise by the people of complete control over public expenditure. Money is the vital principle of the body politic; the public treasury is the heart of the state; control over public supplies means control over public affairs. Any method of procedure, therefore, by which a public servant can veil the true meaning of his acts, or which allows the government to enter upon any great enterprise without bringing the fact fairly to the knowledge of the public, must work against the realization of the constitutional idea. This is exactly the state of affairs introduced by a free use of public credit. Under ordinary circumstances, popular attention can not be drawn to public acts, except they touch the pocket of the voters through an increase in taxes; and it follows that a government whose expenditures are met by resort to loans may, for a time, administer affairs independently of those who must finally settle the account.

This evil of the funding system may be more clearly presented through the analogy of an argument with which all are familiar. It is sometimes said by writers upon finance that direct taxes are the only true taxes for popular governments. They rely for such a conclusion upon the fact that when one pays a direct tax he is conscious of the burden imposed, and will naturally be led to inspect with care the projects of the government. On the other hand, it is claimed that indirect taxes were invented as a means of extracting money from the people in such a manner as to avoid too close scrutiny into public affairs. There is some truth in this view of the case, although it may be easily pressed too far. Were it possible for government to be carried on by direct contributions, the healthy jealousy with which each individual would follow his payment might do much to confine fiscal demands to proper purposes, and to secure economy in the use of moneys appropriated. In this sense, direct taxes are more in harmony with popular government than indirect contributions.

With how much greater pertinency may this reasoning

be applied to the employment of public credit as a source of revenue! A loan calls for no immediate payment from the people, but produces vast sums for the government. It requires a certain degree of thought to recognize that debts imply burdens, and for this reason a government that resorts to borrowing may for a time avoid just censure. Loans do not, like direct taxes, demand a visible payment from the people; nor, like indirect taxes, raise the price of consumed articles. They address themselves rather to the interests of those who have control over capital, and by the promise of a perpetual annuity induce the holders of money to intrust it to the state. The administration is satisfied, since its necessities have been relieved without exciting the jealousy of the people; the lenders are satisfied, since they have secured a good investment for their capital and are not bothered with its management; while the people are not dissatisfied because of their profound ignorance of what has taken place. Herein lies the danger of permitting a government freely to mortgage its sovereign credit.

So far as the United States is concerned, the danger of public borrowing here brought to view is more fully realized in matters of municipal control than in the management of State or Federal affairs. The facts that pertain to local treasury management are indeed appalling. It is not too much to say that every rule laid down by the science of finance has been disregarded by American cities. Demands have been made for unnecessary purposes; demands for necessary purposes have been made in excess of the requirements of economical expenditure; while the entire business has been so veiled behind municipal bonds and suppressed contracts, that the public is kept in general ignorance of what is going on. Out of a total city indebtedness of \$682,000,000 as reported by the census of 1880,¹ the sum of \$122,000,000 is traceable to the funding of floating debts. There is of course a legitimate use that can be made of floating

¹ Porter's "Report on Public Indebtedness," p. 482.

debts, but in city administration their use has been for the most part illegitimate. Without charging criminal corruption upon city officials, one may say that the true interpretation of this large sum of floating obligations is, that those in authority have engaged in public duties while yet the citizens were ignorant of the fact. One can not suppose that this would have been permitted, had every increase in expenditure entailed an immediate increase in the tax levy. The great danger to self-government in the United States lies in municipal corruption, and municipal corruption is in large measure traceable to the manner in which cities have used their credit. For American readers, this reference to local government is a pertinent illustration of a most dangerous political tendency of deficit financing.

But what may be said of the political tendencies of international borrowing? Usually an international contract of this sort lies between the government of a weak people on the one hand, and the subjects of a strong government on the other, and it will assist our analysis if we keep this fact in mind. The tendency of foreign borrowing is in the same direction as that of domestic borrowing. As the latter obstructs the efficiency of constitutional methods, so the former tends to destroy the full autonomy of weak states. The granting of foreign credit is a first step toward the establishment of an aggressive foreign policy, and, under certain conditions, leads inevitably to conquest and occupation.

The relation that exists between foreign borrowing and the political tendency here pointed out will be readily seen if we inquire respecting the position of international law upon unsatisfied claims of any sort. This position is stated by Vattel, as follows:

If one nation . . . refuse to pay a debt, repair an injury, or give satisfaction to another, the latter nation may seize something belonging to the former, and apply it to her own advantage, till she obtains payment of what is due her, together with interest and damages.¹

¹ "Law of Nations," Book II, § 242.

Such a seizure may not itself be considered a reprisal, but it becomes a reprisal upon subsequent refusal of the delinquent government to give satisfaction; such a seizure, therefore, would hardly be made unless the aggressive nation were willing to support its action by arms. A claim, then, of such a nature that one nation would feel itself justified in making seizure of the property of another nation—and an unpaid debt creates such a claim—is recognized as just occasion for war.

But one must further inquire if this rule is at all modified by the fact that the international obligation is not between two states in their sovereign capacity, but an obligation that a state as a sovereign has entered into with the subjects of another state. Would an unsatisfied claim held by a private person against a foreign government become a proper subject for diplomatic correspondence, if disregarded by that government?

The principle of law above stated is not in the least modified by the fact that the claim is private rather than public. Says Vattel:

The property of the individual is to be considered in the aggregate as the property of the nation with respect to other states. It, in some sort, really belongs to her, from the right she has over the property of her citizens, because it constitutes the total sum of her riches, and augments her power. She is interested in that property by her obligation to protect all her members.¹

Phillimore treats directly the question in hand. He says:

The right of interference on the part of a state, for the purpose of enforcing the performance of justice to its citizens from a foreign state, stands upon an unquestionable foundation, when a foreign state has become itself the debtor of these citizens.²

In 1848 this question was raised in England, and Lord Palmerston, in a circular letter to the British ambassadors,

¹ "Law of Nations," Book II, § 81.

² "Commentaries upon International Law," Book II, p. 26.

stated definitely the position of England respecting it. The following is quoted from that letter:

As some misconception appears to exist in some of those states with regard to the just right of her Majesty's Government to interfere authoritatively, if it should think fit to do so, in support of these claims, I have to inform you, as the representative of her Majesty's Government in one of the states in which British subjects have such claims, that is for the British Government entirely a question of discretion, and by no means a question of international right, whether they should or should not make this matter a subject of diplomatic negotiation. If the question is to be considered simply in its bearing upon international right, there can be no doubt whatever of the perfect right which the government of every country possesses to take as a subject of diplomatic negotiation any well-founded complaint which any of its subjects may prefer against the government of any other country, or any wrong which from such foreign government those subjects may have sustained.¹

It appears, then, when a sovereign state enters into a contract with a citizen of a foreign state, that any disregard of the stipulations of the contract may be made the occasion of diplomatic negotiation; and diplomatic negotiation may mean anything, from a polite request that a complaint be taken under advisement, to occupation and territorial conquest. Payment of a domestic debt may be refused with impunity, but there is no such thing as repudiation of a foreign debt except through the acquiescence of the government of which the creditor is a citizen.

It does not, however, follow from what has been said, that the delinquency of any people to meet their obligations must necessarily lead to foreign complications. No citizen can demand from his government the enforcement of a contract he may hold against a foreign government. Whether or not this shall be undertaken lies wholly within the discretion of his government. He can urge no expressed right in the matter, except so far as this may be included in his general right to claim common protection.

A case arose a few years ago in the English courts which

¹ Quoted from Phillimore's *Commentaries*, Book II, p. 27.

well illustrates this point. The Peruvian Government had borrowed money in England, and mortgaged the proceeds of the sales of shipments of guano for the payment of the loan. The contract contained this stipulation : "That the government specially and exclusively hypothecates the whole of the guano that shall be imported into the United Kingdom of Great Britain and Ireland, and the whole of the proceeds of such guano, after deducting expenses, to the payment of said bonds and a sinking fund for their redemption." The proceeds were otherwise appropriated, and holders of the Peruvian bonds endeavored to obtain remedy in the courts. It was held that there was no remedy within the power of the court for a wrong done by a sovereign power in its sovereign capacity; for, if proceedings demanded by the plaintiff were allowed, "it might alter the relation between the two countries, and enable a bondholder, by aid of the court of chancery, to declare war against a foreign country."

The foregoing facts respecting public law are in many ways significant. From the analysis of the previous chapter it was learned that the wide-spread confidence of capitalists in lending money to home governments was evidence of the influence of the moneyed classes in the councils of the state, and we now perceive that the readiness with which capitalists loan money to foreign governments rests largely on the same fact. Provided only that the government borrowing money has jurisdiction over a docile people working a rich soil, and makes no pretensions to military or naval strength, its bonds may be readily sold. They who purchase such bonds place little confidence in the honesty of the borrowing state, but they have every reason to rely upon the willingness of their own government to enforce the contract.

But, in the second place, the facts disclosed permit one to understand how deficit financing, carried so far as to result in an interchange of capital and credit between peoples of varying grades of political advancement, must endanger the autonomy of weaker states unable to meet their debt-payments. Provided only that the interests involved are of

sufficient importance to make diplomatic interference worth the while, the claims allowed by international law will certainly be urged against the delinquent states, and the citizens of such states may regard themselves fortunate if they succeed in maintaining their political integrity.

Many refuse to recognize the presence of this political tendency in the practice of international borrowing, and in support of their position call attention to certain cases of repudiation that have been permitted to pass with impunity. The facts which they recite are undoubtedly correct, but it is also true that solicitude for the interests of bond-holders has led to such interference with the internal administration of weak states as practically to destroy their independence. Another fact, also, must be permitted its due importance. Until within a few years, the English have been by far the largest purchasers of foreign bonds; but since the fall of the Russell ministry it has been the policy of England to retire from the arena of international politics. One reason, therefore, why the full rights of debtors has not been insisted upon is, that the aggressive measures which the enforcement of those rights would have required were contrary to the principles of England's policy. But at the present time England no longer enjoys the distinction of being the only people with considerable sums to lend. The Germans, the French, and the Italians, have enlarged by a considerable figure their investment in foreign loans; and, under the direction of that spirit of intense nationality by which these people are led, the smaller states can not longer expect that immunity from interference which they have enjoyed in years past. Indeed, England herself, by the imperial policy of a Tory administration, has been turned from her avowed purpose, and now finds herself practical dictator of Egypt.

It is of some importance that this tendency of international borrowing to establish tributary relations should be placed beyond question, and for that purpose it may be well to inquire what the current history of Egypt has to say re-

specting the matter. Egypt is said to be a dependency of Turkey, although by the treaties of 1841, 1866, and 1873, she secured administrative independence. At the present time, Egypt is deeply in debt. Upon July 1, 1882, her obligations amounted to £109,016,650, classified as follows:

Funded debt (two fifths being preferred stock).....	£79,514,780
Secured upon estates revenues.....	17,583,070
Secured upon tribute paid direct to loan agents.....	11,918,800

Egypt is thus bearing a per capita debt of £19 15*s.*, and an annual per capita charge of 18*s. 4d.* The real weight of these obligations will be the better perceived when one learns that, in 1878, three-fifths of the entire Egyptian revenue went to the support of the debt service. The greater part of these obligations, about £80,000,000, has been contracted since 1868, and under the administration of Ismael Pacha. According to a report made by Mr. Cave, in 1876, the evils of Egyptian financing were due to a combination of two opposite causes:

She suffers from the ignorance, dishonesty, waste, and extravagance of the East, and at the same time from the vast expense caused by hasty and inconsiderate endeavors to adopt the civilization of the West. Immense sums are expended upon unproductive works, after the manner of the East, and on productive works carried out in the wrong way, or too soon.¹

The grandeur of the royal dwellings is testimony to the truth of one part of this statement, and the machinery brought in from the West, that lies rusting along the roads of the country, bears evidence to the other. Had the persons who supplied the Khedive with money felt that his promise was their full guarantee for repayment, it is by no means sure that they would have been so lavish with their credit.

But we are especially interested in the international relations established upon the basis of these obligations. The holders of these bonds are subjects of England, France, and

¹ "Fenn on the Funds," p. 424.

Germany, and all that these governments have done has been to protect the interests of their subjects. The first step toward foreign interference in Egyptian affairs was the appointment of a special commission by the British Government, at the request of the Khedive, to examine into the financial condition of the country. This request was made at the time when England purchased certain shares in the Suez Canal then belonging to the Egyptian Government. Mr. Cave, the head of the commission, made his report in March, 1876; but, as "his recommendations did not suit the French financial houses which had pandered to the Khedive's extravagance," they were promptly rejected. Three months later, Mr. Goschen was requested by the "council of foreign bondholders" to represent their interests in Egypt, and with him was associated M. Joubert, to look after the interests of French citizens. These gentlemen proceeded to Egypt, and succeeded in securing certain guarantees from that government for prompt attention to obligations in the future. Were it our present purpose to learn if Egypt has been fairly treated by her Christian neighbors, it would be necessary to consider the terms of the "unification" scheme (or, more properly expressed, the refunding operation) that took place in the early part of 1877. But our study is not in this sense judicial. The only part of this scheme of importance to us, as illustrating a political tendency of public debts, is the character of the guarantees secured to the creditors. The loan of 1870 was a "viceroy's loan," and to insure its payment the Khedive expressed a willingness to sell his estates. For certain other loans—those of 1862, 1868, and 1873—the railways, which were a special security, were placed under the direct control of a commission, composed of two Englishmen, one Frenchman, and two Egyptians. Of this commission an Englishman was to be chairman. There were other provisions of this same general character. Passing over the following year, we find that in 1878 an additional loan of £8,500,000 was placed by the Rothschilds of London and Paris. The basis of this loan was family property of the

Khedive, transferred to the state and applied to the support of the debt. The sixth article of the decree creating this debt is as follows :

In order further to secure the said loan, a Special Commission will be formed to administer the said property. The Commission will be composed of three members—an Egyptian, an Englishman, and a Frenchman; and it shall be under the direct control of the Council of Ministers.

The two foreign members will be appointed by us on the nomination of their respective Governments.

The functions of the said administrators will be as follows :

- (a) To manage the property.
- (b) To collect the revenues.
- (c) To remit all the net revenues to the contractors of the loan.¹

To this arrangement both the English and the French Governments assented, although both, in assenting, disavowed all responsibility for Egyptian affairs. In 1879 Ismael Pacha was forced to abdicate, and in August of that year Prince Tewfik was formally invested with power. The practical result of this step was that the entire administration of the country was thrown into the hands of England and France, through two controllers-general. The decree establishing these offices is so pertinent to our subject that I give it in full. It is as follows :

ART. 1. The Controllers-General have full powers of investigation into every public service of the state, including that of the public debt. Ministers and all public officials of every rank are bound to furnish the controllers, or their agents, with all documents they may think fit to require. The Minister of Finance is bound to furnish them weekly with a statement of receipts and expenditure. Other administrations must furnish the same every month.

ART. 2. The Controllers-General can only be removed from their posts by their own Governments.

ART. 3. The Governments of England and France having agreed that for the moment the Controllers-General will not take the actual direction of the public service, their duties are limited at present to inquiry, control, and surveillance.

¹ "Fenn on the Funds," p. 429.

ART. 4. The Controllers-General take the rank of Ministers, and will always have the right to assist and speak at the meetings of the Council of Ministers, but without the power to vote.

ART. 5. When they deem it necessary, the Controllers may unite with the Commissioners of Public Debt to take such measures as they may deem fit.

ART. 6. Whenever they may deem it useful, and at least once a year, the Controllers will draw up a report on all questions, for the Khedive and his ministers.

ART. 7. The Controllers have the power of naming and dismissing all officials whose assistance is of no use to them. They shall prepare a budget; and monthly statements of all salaries and all resources shall be made to them.¹

The foreign appointees under this decree were Major Baring and M. de Blignières, and their first report contained the information that Egypt was bankrupt, and could not meet in full her obligations. The next move was the appointment of an International Commission of Liquidation, and, by the construction of this commission, the Egyptian debt question was declared to be a question of European politics. Besides those states that had already taken a hand, Germany, Austria-Hungary, and Italy were invited to assist by council and vote. It was against such interference in domestic administration that the national party, headed by Arabi Pacha, arose in rebellion. Their cry was, Egypt for the Egyptians. Perhaps they meant, as was claimed in England, Egypt for the Egyptian army. But what is pertinent to the subject in hand is, that this revolution led to an armed interference, and an armed occupation of the country by a foreign power.

Such is the story of Egypt, so far as her bonds are concerned. In the Egyptian question as a whole, there are more elements and interests than those arising out of the indebtedness of the country. My only purpose in presenting this record is to draw from current history an illustration of the claim that the custom of foreign borrowing endangers the autonomy of weak states; and certainly the latest history of

¹ "Fenn on the Funds," p. 431.

this most unfortunate people serves perfectly such a purpose.

Another illustration, fully as humiliating, is found in the occupation of Tunis by the French. Here the influence of the bondholder is even more clearly traceable than in the case of Egypt. Previous to the late occupation, she had among her officials a French inspector of finance and six delegates or commissioners, and the curious fact is, that these commissioners were not appointed by the governments, but elected by the English, the French, and the Italian bondholders. There could not be a fact more pertinent for showing what a tyranny individualism, combined with the ruling idea as regards property, is preparing for the world; or how that a principle which, abstractly considered, is most just, may, in its extreme workings, destroy the very claim to justice upon which it at first rested.

But our analysis of the political tendencies of international borrowing is not yet complete. It is not alone that the weaker states are in danger of losing their administrative integrity that draws our solicitous regard to this subject. Such a result might not be altogether a misfortune, should the period of their subjection serve as an apprenticeship in good government. Of equal importance is the fact that widely extended credit relations introduce new and perplexing complications between the greater powers themselves. It is not difficult to see how this comes about. When a first-class power obtains control over a smaller state its weight is increased in the councils of the nations. The established balance of power is thereby destroyed, and the diplomacy of suspicion is introduced. For example, the occupation of Egypt by England means, whatever the government may say, practical control of Egyptian affairs. As a consequence, the other powers of Europe demand either that they shall have a voice in giving direction to that control, or that England shall not interfere with their schemes of the same sort. The international conference of 1884, called to take under advisement the question of Egyptian finances, is of too recent

an occurrence to call for a detailed account. It was proposed by Mr. Gladstone to reduce the interest upon the Egyptian debt. France would not consent to this, and Germany, for reasons known best to herself, upheld the decision of France. England was therefore obliged to proceed with her plan for reform upon her own authority, and when she proposed to divert certain revenues from the sinking-fund to other purposes the powers of Europe protested. Thus this Egyptian question, pressed upon the attention of governments by the interests of bondholders, bids fair to become one of the most serious of modern problems.

It appears from our foregoing study that there are three distinct and decided political tendencies bound up in the practice of modern financiers. It obviates the free workings of constitutional governments; it endangers the autonomy of inferior states; it introduces complications of a serious nature between the larger powers. Nor can it be said that these tendencies are without practical interest to the people of the United States. It is the acknowledged purpose of the citizens of this country to realize the principles of Democracy under the form of a Republican government. That which the great numbers demand is self-government; but, as has been pointed out, the employment of public credit works against the attainment of this purpose. It comes then to be of the highest moment that this theory of treasury management, if employed at all, should be employed under the guidance of strict financial rules.

With regard to the danger to political autonomy entailed by a free use of public borrowing, the United States has no cause for apprehension. For not only is this country at present independent of European money markets, but her strength as a nation would forbid any interference with her internal affairs. But, on the other hand, there are many reasons why the United States should be on her guard against diplomatic complications arising from the prevalence of public borrowing. Many of the peoples of Central and South America are debtors in large amounts, and their bonds are held in Europe.

Suppose payment on these bonds to be delayed, what has the United States to say should foreign governments proceed on the accustomed lines of diplomatic interference? Shall our country permit England and France to repeat on this side of the Atlantic the Egyptian or the Tunisian episode? Shall European creditors be allowed to appoint cabinet officers in any American Republic? The Monroe doctrine is all that can be opposed to such a policy, but the Monroe doctrine has never been accepted as part of international law. It is merely the expression of a sentiment on the part of the people of this country, and may require the argument of force to secure for it general recognition. The attempt made by England, France, and Spain to obtain from Mexico some "material guarantee" for the payment of certain claims forms part of the history of the immediate past. In this instance, as will be remembered, the movement failed. The United States happened at the time to have an army and a navy, and the statement of the Monroe doctrine by Mr. Seward carried with it some weight. It soon became apparent to England and Spain that France was acting in bad faith, and they withdrew from the enterprise; while the fact that the claims urged by Napoleon III were in themselves spurious, took from the Emperor the sympathy of his own subjects, and rendered him the laughing-stock of Europe for thus endeavoring to bring into the present century the politics of the court of Louis XIV. But the issue of this particular enterprise is of slight importance. It is the fact that France undertook the conquest of Mexico, basing her claims for action upon unsatisfied obligations, that renders the question of international indebtedness of importance to the United States.

Another thought is naturally suggested in this connection. According to the constitutional law of the United States, the several States of this Union are clothed with complete sovereignty so far as the employment of their credit is concerned. That is to say, Federal law can exercise no control over questions of local indebtedness. But international law

declares that an unsatisfied obligation constitutes a just occasion for diplomatic interference. Suppose, now, one of these local governments to repudiate a debt, and that a foreign power desires to protect the interests of its citizens who may be holders of the bonds—to whom can it present its demands for redress? It would certainly be useless to present them to the States, for such demands involve questions of peace and war, and for that reason are assigned by the Federal Constitution to the control of the Federal Government. There is thus suggested a curious anomaly in American law. The Federal Government is imposed with a duty of negotiating upon a question over which it has no control; while the States are permitted to institute proceedings for the consequences of which they are not responsible. It may be that, in the light of our past history, this condition of affairs does not constitute a practical criticism upon American institutions, but it certainly discloses a lack of harmony in public law.

If, however, the relation of debtor and creditor, assumed in the above instance, be reversed, another class of possible foreign complications is at once suggested. The citizens of this Republic have as yet shown no inclination to invest in the obligations of foreign peoples, because greater profit has been secured from other methods of placing capital. But when we notice the amount of wealth in this country, and the extent to which it is concentrated, when we perceive that the field of industry is continually becoming narrower, and when to these facts we add that the Federal debt is in rapid course of expungement, and that the constitutional limitations placed upon the States and minor civil divisions exclude them from the money market as borrowers, we are led to recognize the increasing difficulty of safely and profitably investing free capital. It would not, therefore, be at all strange should capitalists in this country begin to show a personal interest in the fluctuation of foreign stocks. It lies altogether within the range of possibilities that the city of New York, like the cities of London and Paris, should become a storehouse of capital to which the sovereigns of petty

states may resort to fill their depleted treasuries. This tendency is fraught with danger to the policy of isolation thus far maintained by the United States, and it becomes an important question, what attitude this country should assume with regard to the interests of those who place their funds beyond the control of American law. One of two policies must be declared, nor ought the nation to be permitted to drift in this matter. Either citizens of this Republic should know that money placed in foreign bonds is at their own risk, or they should prepare themselves to see questions of foreign policy become much more important than they now are.

It seems, then, from whichever point of view we consider the question, that the United States can not reasonably expect to avoid political complications sure to come with an extension of international credits; and it is on this account desirable that the Federal Government should present a clearly formulated policy, upon which the public may rely.

CHAPTER III.

SOCIAL TENDENCIES OF PUBLIC DEBTS.

Nor a few of those who observe social facts are inclined to discover in all political and industrial relations evidence of social injustice. For such, public debts have ever been a favorite topic of study. It is undoubtedly true that our present social order provides abundant evidence of unfairness as between man and man. The great class of non-possessors have a case which, if properly presented to the moral sense of the world, would secure judgment in their favor; but they may pertinently inquire if their case is not weakened by the usual discourse of their advocates respecting public debts. Indeed, the greater part of what is said upon this subject shows an imperfect analysis of social relations, and fails altogether to distinguish between causal and resultant facts.

For a rational discussion of the question here brought to our notice, it will be necessary first to state clearly what is meant by a social tendency. This phrase is properly appreciated when it brings to mind all those forces which in any way influence the relation of classes in society. There are, however, but two ways in which a social tendency may manifest itself. It may work some change in existing classes, or it may lend its influence to render permanent such classes as are already established. The only social tendency exerted by public debts is of this second sort.

It may be urged as against this claim that large fortunes have been made by the purchase of bonds at low prices, and

their subsequent sale upon a rising market. For example, when the first Federal Administration declared its intention to make provision for the payment of the debt incurred during the Revolutionary War, the price of outstanding paper rose rapidly upon the market. Even before Hamilton's report upon public credit, public securities had experienced a rise of nearly one hundred per cent, as compared with what they were in the early part of 1789. There were, indeed, some very pretty fortunes made by those who "expressed their confidence in the government," and purchased its obligations at thirteen cents on the dollar.

The financial conduct of the late civil war also offered a rich harvest to the money-lender. The net proceeds of loans during the continuance of that war was \$2,565,000,000. But this sum, which was received in depreciated paper, represented a gold value, estimated on the basis of quarterly returns, of but \$1,705,000,000. The difference between these two sums shows the amount of fictitious capital that fell into the pockets of those who "trusted the government in its time of distress." A similar result followed upon the refunding operations of 1870. Federal bonds which were taken at 100 have since risen to 120, thus giving to those who sell them a premium of twenty dollars for every one hundred dollars invested, in addition to the ordinary interest payments while the bonds are held.

It must then be admitted that fortunes have been made by dealing in government paper. In a slight degree, also, such results may be regarded as the natural workings of deficit financing, for it is true that bonds issued during the continuance of a fiscal emergency will not command their normal price. Still this can not be accepted as proof that the policy of public borrowing contains a decided tendency toward the separation of classes on the basis of property. Private fortunes made by dealers in bonds may be evidence merely of bad financial management on the part of the administration; but of more importance is the consideration referred to in the first chapter of this treatise, that private

property must have been concentrated to a considerable degree before the borrowing system could have been developed. Men hold bonds because they are rich, they do not become rich by holding bonds. At least this will not be the case when bonds are issued and managed according to sound rules of finance.

But has such a conclusion any practical significance? There are a few writers who advocate repudiation of public indebtedness as a first step in the solution of the problem of industrial inequality,¹ and, from the above analysis, the futility of such a proposal becomes apparent. The placement of a public debt, while it may create a bondholding class, does not create the class of rich men who, by lending their wealth to the government, become bondholders. The existence of such a class is but one of the many manifestations of inequality in possessions. It is a resultant, not a causal fact; and on this account it is unreasonable, because of indignation at the manner in which our century lays its burdens and bestows its benefits, to advocate the arbitrary expungement of all public obligations. Such a proposal displays lack of critical judgment. It is inadequate to the end sought, because not addressed to the final cause of that of which complaint is made.

This question, however, presents itself in a little different light when we consider the tendency of deficit financing to render permanent such class relations as are already established. The social significance of public debts springs from the fact that, wherever existing, the citizens of a state are divided into two classes—those who pay taxes for the support of the debt, and those who receive interest payments out of the proceeds of the taxes. It is not intended to imply that holders of bonds form a distinct class in the community, but rather that there always exists in a country burdened with debt an interest peculiar to the holders of bonds.

¹ Cf. "Brief Reasons for Repudiation Applicable to the War Debts of all Countries," by Isaac Butts. 1869.

And when we remember that industrial leisure, rendered possible by proprietorship in fixed investments of any sort, is a habit easily acquired, we may discern how the funding system readily lends its influence to the permanency of class relations.

This effect of deficit financing may be seen in the sentiment that always controls the moneyed classes with reference to the debt payment. Whenever a great national emergency demands the creation of a debt, the enthusiasm of patriotism leads to its willing support, but it is nevertheless regarded as a public calamity. When, however, the finances of the country become adjusted to the annual interest payments, and the people accustom themselves to the taxes required, one may hear from influential quarters frequent expression of the opinion that the permanence of a national debt is essential to commercial interests. This has been the result in the United States of twenty-five years' acquaintance with public bonds used as commercial paper. One of the foremost papers of the city of New York endeavored recently to arouse sentiment against the rapid payment of the public debt by charging upon that policy the business depression affecting the country. Its argument was that good investment could not be found for as much free capital as was thrown upon the market by payment of the debt, and that no capital would seek investment because the rate of profit was in this manner forced to a low figure. The suppressed conclusion involved in this bad logic is that the government should continue to tax the people for money with which to continue the payment of interest upon its debt rather than flood the market with free capital. I observed another illustration of this same tendency when reading, a few years ago, the proceedings of the Bankers' Association. A leading citizen of Chicago, speaking before that body, expressed the opinion that this country could not afford to reduce its debt, for the payment of the debt endangered the national banking system. Such expressions as these show how easy it is for men to convince themselves that what proves to be of per-

sonal advantage must of necessity benefit the community at large, and they are illustrations, also, of the fact that class interests easily crystallize under the influence of an extended and permanent system of indebtedness.

It should be further noticed, in this connection, that the social influences which accompany the employment of sovereign credit depend largely upon the manner in which public funds are distributed among the citizens of a debtor state. The opinion is quite prevalent that a widely-diffused debt indicates a healthy condition of political and industrial society. Thus it is the constant theme of self-gratulation on the part of French writers that so large a number of French subjects are enrolled as creditors of the state. This fact discloses what they call the democratization of the public funds. ("*On voit combien la rente était démocratisée.*") Between 1870 and 1876, the debt of France doubled in amount, but the holders of the debt increased by four times the original number. Upon December 31, 1876, the number of titles upon the books is said to have reached the enormous figure of 4,404,768.¹ Viewed as a purely financial question, however, it is no occasion for congratulation that a debt is widely diffused. Not only is its management necessarily more expensive, but the facility offered to politicians to use the debt for party and personal ends often defeats the best purposes of the financier. This same France, for example, continued to pay for a number of years a higher rate of interest than was necessary because the government feared the voting power of the holders of rentes.² Nor do industrial considerations necessarily lead to the approval of a widely-diffused debt. The unfailing indication of a healthy state of industries is found in the personal attention of all members of society to business affairs, and this can only come with personal interest in some particular form of product. In so far as the private income of individuals arises from payments of

¹ "Traité de la Science des Finances," Leroy-Beaulieu, vol. ii, p. 544.

² "Les Finances de la République," H. Le Trésor de la Roque, pp. 24-29.

interest by the state, the public is deprived of the beneficial workings of that solicitous care which insures success in industrial ventures. If one traces to its origin the sentiment that favors a large rather than a small number of public creditors, he will find that it springs almost entirely from social considerations.

It may be interesting to inquire respecting the holding of Federal bonds in the United States. In this respect, as upon most questions pertaining to finance, the customs of the American people differ widely from those of the French. There is presented in this country the spectacle of a highly centralized public debt. One need not fear that a popular vote will demand the maintenance of public obligations as a convenient species of productive property, or that the government should continue a larger interest payment than the stipulation of the bonds or the condition of the market requires. The only source of information respecting the distribution of Federal obligations is the report upon public indebtedness that forms part of the publications of the tenth census. The facts presented, therefore, pertain to the year 1880, but there is no reason to believe that the relations disclosed have been materially modified.

The registered debt of the United States, as it appeared during the summer of 1880, amounted to \$1,173,749,250. Now, the reader is especially requested to notice the number of deductions that must be made from this sum before the question of personal holding by citizens of this country can be discussed at all, for, if these deductions be lost sight of, the figures presented will not adequately measure the concentration of bondholding interests. In the first place, our present calculation has nothing to do with the amount owned by foreigners; as this amount was found to be \$27,894,350, there remains \$1,145,854,900 to be accounted for among the citizens of the United States. Of this sum, \$319,937,800 was held by the national banks, as security for their circulation, which must also be deducted from the grand total; for

not only is its chief social influence exerted through its connection with the circulating medium of the country, but it is under corporate and not personal holding. The census authorities further excluded from their final analysis the sum of \$180,926,700 of six per cents.¹ As a result of these various deductions, there remains the sum of \$644,990,400; but there is included in this a large amount of debt, the property of private banks, insurance companies, trust companies, and other corporations, calling for a yet further deduction of \$227,451,550. It thus appears that out of a total of over one billion of registered debt, private citizens of the United States were proprietors of the comparatively small sum of \$417,538,850.

The amount subjected by the census authorities to a classified analysis is \$644,000,000, made up of bonds bearing respectively 4, 4½, and 5 per cent interest. The various sums for each class of bonds, as well as the number of holders in each class, is presented in the following table, to which is added a similar classification of the six per cents already spoken of:

LOANS.	Number of holders.	Amounts.	Holders, per cent.	Amount, per cent.
4 per cent.....	55,278	\$384,742,800	68·41	46·58
4½ per cent.....	10,745	125,631,800	13·30	15·22
5 per cent.....	9,091	184,616,800	8·78	16·29
6 per cent.....	7,688	180,926,700	9·51	21·91
Totals.....	80,802	825,917,100	100·00	100·00

¹ The statement of the report with regard to these bonds is as follows: "The interest on the 6 per cent bonds of 1880 and 1881 was made payable semi-annually (July and January), in the ten principal cities of the country, New York, Boston, Philadelphia, Baltimore, Chicago, Cincinnati, Washington, San Francisco, St. Louis, and New Orleans, and not sent direct by draft to the holders. The treasury books were sent direct to the sub-treasuries of these cities, and the owners or persons authorized called and receipted for the interest. These bonds, aggregating at that time \$180,926,700, were owned by 7,688 corporations and private individuals; 4,239 of these holders received their interest in New York city, 1,611 in Boston, 1,806 in Philadelphia, 248 in Baltimore, 42 in Chicago, 54 in Cincinnati, 169 in Washington, 10 in St. Louis, and 9 in New Orleans."

Analysis of the holding of Registered Bonds, as described, for 1880.

CLASSES DESIGNATED BY AMOUNTS HELD.	Number of male holders.	Amounts held by males.	Number of female holders.	Amounts held by females.	Number of corporations holding.	Amounts held by corporations.	Total number of holders.	Total amounts held.
I. From \$10 to \$500	18,309	\$4,087,080	12,248	\$8,472,700	56	\$16,160	25,613	\$7,555,900
II. From \$500 to \$1,000	8,368	7,449,750	6,372	5,591,100	59	56,400	14,799	18,097,250
III. From \$1,000 to \$2,500	7,505	13,402,300	4,871	8,582,850	53	97,400	12,529	22,032,550
IV. From \$2,500 to \$5,000	5,490	21,406,300	2,861	11,032,950	149	681,700	8,500	38,070,950
V. From \$5,000 to \$10,000	3,416	27,090,900	1,571	12,285,400	196	1,753,600	5,183	41,079,900
VI. From \$10,000 to \$25,000	2,326	38,861,750	958	16,395,600	269	4,886,500	3,538	59,143,850
VII. From \$25,000 to \$50,000	1,018	38,688,100	281	10,745,850	224	9,314,650	1,633	68,780,600
VIII. Exceeding \$50,000	880	176,239,350	168	28,344,900	631	210,695,150	1,529	410,279,400
Grand totals.....	42,262	\$327,185,500	29,325	\$90,383,350	1,627	\$227,451,550	78,114	\$644,980,400

The total amount, it will be observed, is made up of the total registered bonds, excluding the sums held by foreigners, and the amounts deposited by the National Banks as security for their notes. The number of holders is 80,802. Compare this number with the 4,404,763 holders of the French debt.¹

What, now, is the manner in which these \$644,000,000 of registered bonds are distributed? The accompanying table presents two sorts of classification. First, the holders themselves are classified according as they are male, female, or corporate, and the amounts respectively belonging to each class are designated. In the second place, there are eight sub-classifications according to the sums registered for each class. For example,

¹ It should, however, be stated that separate entries on the Government's books do not necessarily mean separate holders. Nor does M. Leroy-Beaulieu leave the impression that there are so many holders of the French debt. He himself estimates (p. 548) from 1,254,040 entries in 1869 that the owners of the debt numbered between 700,000 and 800,000.

Class I includes all who hold bonds in sums varying from \$50 to \$500, while Class VIII embraces holdings exceeding in amount \$50,000. The several amounts for each class may be read from the last column of the table.

There are two conclusions of importance that spring from the figures presented in the above table. In the first place, whatever social influences flow from concentrated holding of the public funds, must make their appearance in the United States, should the present policy of debt-payment be arrested and a system of permanent indebtedness be established. The population of this country in 1880 was fifty millions; the number of individuals holding registered bonds was 71,587. Other citizens may be interested in the public debt through their ownership of stock in corporations that hold it; but when one remembers how corporations stand related to the question of social inequality, this fact can not alleviate the harshness of the conclusion suggested. But again, if the figures presented be even approximately correct, they do not allow much ground for the argument that a public debt should be maintained in the interest of "widows and orphans." One frequently hears that a permanent debt is a good thing because it permits easy and safe investments for the funds of those who are weak and dependent, but this consideration is not warranted by the figures presented. This will appear in its clearest light by a grouping of figures from the previous table. If we drop from our notice the last four columns, and place the figures pertaining to the first five classes in contrast with those that remain, the result will be as follows:

CLASSES.	Number of males	Amounts held by males.	Number of females.	Amounts held by females.
I to V inclusive....	38,088	\$73,416,800	27,923	\$40,865,000
VI, VII, VIII.....	4,174	253,769,900	1,402	49,488,350

This presentation offers slight encouragement to those who look upon public debts as a means by which a beneficent

government may exercise its paternal care. It is true that some widows and orphans invest in the public funds, but when the respective amounts of large and small holders are placed in contrast, and when it is noticed that out of a total of \$664,000,000 of registered bonds \$410,000,000 are held in sums of \$50,000 and over, it seems a little ludicrous to urge the maintenance of a Federal debt as a measure of charity to dependent persons.

But this matter of the distribution of public indebtedness may be regarded from another point of view. So far as social results are concerned, the territorial holding of public obligations is of as much importance as their personal ownership. For, in the first place, this shows the centers at which wealth is concentrated, since debt paper will naturally flow to that market where there is free capital to absorb it. This class of facts also indicates those parts of the country which, on account of some past service, have a recognized claim to annual payments from the general proceeds of taxes. Public creditors must live from the product of current industry, but they may be so distributed over the land that the labor which lends itself to their support is not the labor of the locality in which they live. It thus appears that a public debt may be so distributed within a country that the people of one section will be bound in service to those of another section. An analysis of the holding of the registered debt of the United States directed by this thought is full of interest.

*Analysis of Territorial Distribution of Registered Bonds
held by private individuals.*

DISTRICTS.	Amounts held. Corporations excluded.	Percentage of total amounts held.	Percentage of total population. %	Amounts assigned on basis of population.
New England States	\$70,972,050	17	8	\$38,403,108.00
Middle States....	279,008,250	67	21	87,688,158.50
Southern States ...	18,139,800	8	87	154,489,874.50
Western States....	54,418,750	18	84	141,963,209.00
Totals.....	417,538,850	100	100	417,538,850.00

The source of information for the above table is the report on public debts of 1880, but I have summarized the facts there presented, so as to bring to our notice the four well-defined groups of States, the territories and the District of Columbia being grouped with the Western States.

This table can not call for much explanation. From the figures of the first column one learns the amounts of bonds held by the various groups of States; the second column presents the same fact in the language of percentages. The third column shows the proportion of the total population which finds its residence in each of the sections considered, while the last column declares what sums would have been held had the total amount of registered bonds owned by private persons been assigned to the several sections on the basis of population. The disparity of ownership which makes its appearance is the most marked in the case of the Southern States. Here is a section with 37 per cent of the population holding but 3 per cent of the bonds. Were it true that Federal taxation is in proportion to population, the South would be called upon to pay to citizens of the other sections the entire debt charges entailed by \$141,349,574 of bonds, this being the difference between the amount held and the amount assigned. The Western States, also, are in like manner subject to an annual interest payment in favor of their Eastern neighbors. Of the separate States, the two most fortunate in this regard are Massachusetts and New York. In Massachusetts there are 16,885 holders, being 23·04 per cent of the total number; while the amount held is \$45,138,750, being 6·99 per cent of the total amount. The population of this State is 3·66 per cent of the total population. Corresponding figures for New York show that she presents 14,803 holders, being 20·24 per cent of the total number; and that these are proprietors of bonds equal to \$210,264,250, which is 32·60 per cent of the entire sum. The population of this State is 10·14 per cent of that of the United States. In the face of such figures as these it is useless to deny the sectional concentration of the bondholding interest. It may be that

the relation thus disclosed is no more strongly marked than appears in the ordinary course of business, but there is one important distinction that should be noticed. In ordinary business, the relation that exists between the various sections of a country is service and counter-service; the benefit is mutual, or the intercourse would not continue. In the case of bonds, however, the service by virtue of which the proprietors claim an annual payment has been passed for nearly a generation. It is right that this payment should be made, but it is also right that those who hold the claim should make no complaint if those citizens of the United States who are debtors insist upon extinguishing the principal of the Federal debt.

When we notice the concentration of money in and about our great cities, and that the figures presented above are but exponents of a general fact, we can not escape the feeling that the public sentiment of cities is not to be relied upon in matters touching great financial questions. The class interest is too strong. One might as well expect to discover the political sentiment of the public at large by inquiring what the citizens of Washington thought of any proposed measure. The conclusion, then, of the foregoing analysis seems to be as follows: While we may not say that public debts bear with them a distinct and independent social tendency, it is yet true that they exert a social influence in rendering permanent such class relations as spring from disparity of possessions, and that they introduce conflicting interests between citizens.

It may not be inappropriate to add a word respecting the social tendencies of foreign indebtedness. The relation of debtor and creditor, when established between peoples of the same industrial grade, and the same political insight and military strength, can not be said to exert an influence at all different from that which we have previously considered. But when peoples of altogether different degrees of industrial advancement, different habits, different views of life, and different forms of government, enter into this relation,

it is not at all exceptional for the inferior people to find themselves delivered over to practical servitude. Is not this what happened to the Egyptians? Ignorant of transactions in money, they understood nothing of the contracts which their rulers signed, and, since they enjoyed none of the political rights of free men, they would have been powerless to oppose such contracts had they understood them. The parties to this bargaining were, on the one hand, citizens of a strong government with money to lend; on the other, an autocratic ruler of an ignorant people, possessed of the sovereign power of taxation. By means of written bonds, the money was given to the ruler in exchange for the power to tax. The measure of this servitude is found in the annual foreign payments on account of the Egyptian debt, all of which, roughly speaking, passes out of the country. For the year 1882 the receipts of the Egyptian Government were \$44,800,000; the annual debt charges for the same year, including payments to the sinking-fund and payments upon preference bonds, amounted to \$25,000,000. It may be fair to deduct from this amount the sum of \$7,000,000 chargeable to the earnings of property created by the investment of borrowed capital; but there would even then remain an annual payment, from the proceeds of taxes, of \$18,000,000, passing each year out of the country. If now we call to mind the number of English officials in Egypt, the foreign control exercised over her internal affairs, and the management of her taxing machinery in the interest of public creditors, are we not justified in saying that the days of tribute have returned? Is there not again established between strong creditor and weak debtor states the relation that formerly existed between Rome and the barbarian peoples? It certainly seems a little unjust to urge English proprietary rights against people who are ignorant of the English law of property. There appears to be such a thing as an international social question, and one phase of this question is presented in connection with international borrowing.

CHAPTER IV.

INDUSTRIAL EFFECTS OF PUBLIC BORROWING.

It is because a public treasury can be filled only out of the product of current industry that a study of the industrial effects of public borrowing comes to be of importance. For, if governments borrow in such a manner or to such a degree, or so correlate their borrowing and taxing, that industry is thereby discouraged, the source of all revenue will be dried up. Sound rules of treasury management rest upon a clear analysis of industrial relations.

The question thus brought to our attention is perhaps the most difficult of any of the technical questions we shall have to consider, and I can only add that it is fundamental to a proper understanding of the entire subject. It may also be pertinently remarked that this subject offers certain peculiar temptations to the student. Many writers who consider it show great carelessness in tracing causal relations. A panic follows the creation of a debt, a panic follows the payment of a debt; in either case some wise man will surely appear to charge the commercial disaster upon the financial policy of the government. It is a safe rule, and one that I shall endeavor to keep in mind throughout this analysis, to deny a causal relation which can not be traced with some degree of clearness.

Again, the natural desire for simplicity and uniformity of statement has led to many an abuse of good financial maxims. The first lesson in practical finance is that circumstances alter cases. In tracing the industrial effect of loans,

much depends upon the purpose for which money was borrowed; upon the nature of the transaction; upon the industrial condition of the people who bear the loan; upon social relations as indicated by the distribution of property among the people; upon the varying sums in which the loan is held, and the comparative numbers that become creditors of the state, as also upon other conditions that will readily suggest themselves to the reader. Nor are loans themselves homogeneous, but vary in character as do the circumstances under which they are issued. Our conclusions, therefore, respecting the industrial effects of public borrowing must be hypothetical rather than general, and particular rather than universal. We can not expect to discover any grand principle by which financing may be reduced to rule, but we may hope to become more perfectly acquainted with the nature of deficit financing and to formulate certain maxims which will be of assistance in the practical administration of treasury affairs.

The first distinction which it is necessary to notice is one that exists in the nature of loans themselves. Does the placement of debt effect a movement in the capital of the country, or is it followed merely by an adjustment of credits? This distinction between a transaction in capital and a transaction in credit is not difficult to understand. The most simple conception of capital is that of a fund for the subsistence of labor. It means food, clothing, shelter. It means those things in the enjoyment of which the laborer must be guaranteed, before his skill and strength may be drawn from producing them directly for himself to other purposes. But this guarantee being established, by the creation within the country of a large subsistence fund, whoever controls this fund has it in his power to direct labor, and from this it follows that any disturbance in the ordinary application of capital must effect a corresponding readjustment in the application of labor. Public borrowing then comes to be a transaction in capital when, by means of it, the government gains control over a definite portion of the country's labor.

Its influence upon industries must, in such a case, be direct and immediate.

But it is possible for a government to borrow money in such a manner, and to use it in such a way, that the industries of the country are not in the least affected. This is the case when a debt already existing is paid with the proceeds of a new debt, or when floating indebtedness is taken up by the issue of bonds, or when an account is settled between two countries. The full meaning of transactions of this sort is that credits of one kind are given up in exchange for credits of another. The industries of a country are not directly influenced by such a transaction, for it brings no actual capital under the control of the government, and consequently occasions no readjustment in the application of labor.

But, it may be asked, is this distinction ever disregarded? It is of course not denied when thus brought clearly to view, but there are many indications that it is not at all times held firmly in mind. The prevalent disinclination of the part of cities to fund their floating obligations is traceable to confusion in the public mind on this point. The expressions of admiration and wonder occasioned by the ease with which France paid the German indemnity, also, spring from an inadequate analysis of the nature of the transaction. But so pertinent is this operation as illustrating a transaction in credit, and so interesting in itself, when we consider that it was the largest amount of money ever borrowed at one time, that I venture to present at length the manner in which it was carried through.

According to official figures, the entire expense of the Franco-Prussian war was 11,471,000,000 francs. This occasioned the creation of a debt of 9,890,000,000 francs. Of this sum, 5,800,000,000 francs was paid to Germany as a war indemnity, and it is the borrowing of this sum which serves as an illustration of a transaction in credit.

In 1871, on the basis of a law of June 20, the Minister of Finance issued a call for a loan of 2,000,000,000 francs. The proceeds of this loan were 2,250,000,000, which, added to

a loan of 750,000,000 of the year before, made 3,000,000,000 taken by the government in two years. In less than thirteen months thereafter, by a law of July 15, 1873, the treasury authorities were permitted to place another and yet larger loan. This is what is known as the three-milliard loan, the actual proceeds of which were 8,498,000,000 francs. This loan, which was placed by popular subscription, called for ten per cent of the amount subscribed as a guarantee, and permitted the remainder to be paid in nineteen installments, but required that the last installment should be paid before April 14, 1874. The loan took the form of perpetual rentes, and bore interest at the rate of 5 per cent.

Let us now consider the character of the subscriptions. In Paris there were found 34,324 subscribers, whose united subscription amounted to 13,252,455,390 francs. In France, outside of Paris, the subscribers numbered 792,340, whose bids amounted to 4,513,455,566 francs. Besides these, there were 107,612 offers from foreign countries, amounting together to 26,050,195,054 francs.¹ That is to say, there were 924,276 individuals and associations, whose united subscriptions amounted to 43,816,096,010 francs, willing to lend money to the French government. This is a sum equal to \$8,765,219,202 which was placed at the disposal of the government in response to a request for a loan of \$600,000,000.

Now, exclaims the world, what a wonderful country is France! What masterly men must be her financiers! What strength is displayed by her industries in thus furnishing so large a sum for the payment of Germany! Without denying the conclusion as to the greatness of France or her financiers, the payment of the five milliards can not be

¹ This sum estimated in rentes amounted to 1,541,481,660 francs, the subscriptions being distributed among the various nations as follows: Germany, 471,154,815 francs; Belgium, 396,044,820 francs; England, 334,151,215 francs; Alsace-Lorraine, 87,735,015 francs; Holland, 83,986,865 francs; Denmark, 34,402,390 francs; Turkey, 32,917,790 francs; Switzerland, 32,481,285 francs; Italy, 31,078,090 francs; Austria, 30,370,440 francs; Roumanian States, 5,792,765 francs; Asia, 2,814,670 francs.

accepted as proof of industrial strength, for the fact is that French industries did not supply the funds. It is true that for Germany so large a sum of money resulted in an increased control over capital, yet the payment of this sum by France did not immediately entail upon her an equivalent loss. The full effect of this payment was a re-adjustment of credit relations between the French and foreign peoples. It was a transaction in credits. There is in Europe a system of international payments of which we know little or nothing in this country. If, for example, a merchant in Paris wishes to make a payment in Berlin, it is quite customary for him to send securities of some sort to his Berlin agent, which, being sold, permits him to place so much of their proceeds as are necessary to the order of his creditor. The securities thus used are known as "international values." They may be the bonds of any reliable state whose paper can not be retained among its own citizens. Thus the bonds of Italy, Spain, Turkey, and Russia are so used. Railroad securities, as also the paper of other well-established industrial corporations, swell the total of "international values." The point of importance, however, is to recognize the existence of such values, and to understand that by means of them any special stress upon one market may be in part transferred to other money centers. These "international values" act as connecting pipes between great reservoirs of capital.

In the presence of such commercial relations, how far is the placement of a great loan felt in the country where it is issued? To answer this question, one must remember that the credit of a strong state is always higher at home than abroad, and, on this account, if a government advertise for the placement of a considerable loan, the home market will be cleared of foreign obligations to make room for the domestic debt. This is exactly what occurred in the case of the great French loans. Those Frenchmen who held foreign paper sent it abroad in order to secure the necessary funds for the purchase of the new rentes. It was not, then, France that furnished the ready cash for paying the fine of five mil-

liards, but Berlin, London, Rome—indeed, the world at large came to her assistance. And, since the loan did not result in the absorption of domestic capital, French industries were, for the time being, outside its range of influence; its full immediate effect was registered in the changed credits which Frenchmen held. The transaction, in short, amounted to this: that France drew bills of exchange upon her many foreign debtors in favor of Germany. This, of course, was only possible because France had accumulated credits abroad by means of her foreign commerce, which were given up in return for French rentes. It appears, therefore, that the transaction was of the nature of an international refunding operation, and had nothing to do with capital invested in current industry. French exports and imports were not greatly influenced, labor was not diverted from its natural channels, and all domestic trade for the time went on very much as though no debt had been contracted. That which challenges our astonishment is the extent to which international credits have been developed, and not the fact that France was able to raise the money to pay her fine.¹

There seems, then, a clear difference between a financial operation which touches capital and one which merely results in a re-adjustment of existing credits, and it is needless to remark that our further study has to do with such borrowing as exerts a direct influence upon existing industries. The foregoing analysis discloses also a fact of much importance in the prosecution of this study. Since it is through the medium of capital that public borrowing comes into contact with industries, it follows that the industrial effects of borrowing will vary according to the fund of capital moved by

¹ There is a report upon the payment of the German indemnity by M. Léon Say, made in 1875, in which the movements of international credits, previous to the great loans, are traced. This subject is also treated at some length by Leroy-Beaulieu, "Traité de la Science des Finances," vol. ii, pp. 218-227. Compare also "Blackwood's Magazine," vol. cxvii, p. 172, for the terms of the contracts, and the details of payment. Especial attention is called to the ease in which this payment was made without materially affecting international exchanges.

the placement of a loan. It may be difficult to trace with exactness the source from which the government draws its capital ; but the more perfectly this may be done the more accurate will be the judgments of the financier. But in some cases this task is not a difficult one. Thus it is easy to discern if a loan absorbs foreign or domestic capital, and but a slight consideration leads one to see that the industrial effects of borrowing are quite different, according as the funds are supplied at home or abroad.

At the outbreak of a severe war there are certain advantages in placing a foreign rather than a domestic loan, for in this manner the unnatural strain to which a people are subjected, in passing from a condition of peace to that of war, is taken from domestic industries. Any arbitrary change in established business habits or methods is always attended with injurious consequences, and it should be the purpose of the financier, who controls that part of government machinery most intimately connected with business life, to effect all necessary changes with the least possible industrial disturbance. A foreign loan readily lends its influence to this purpose. The proceeds of such a loan do not find their way into the borrowing country as money ; at least, this will not occur in any such manner as to effect an inflation of the circulating medium. It is not money that the government wants ; its demands are either for the products of labor, or for those things by the possession of which it may gain control over labor. It is probable, also, that an emergency so great as to justify foreign loans would result in the establishment of such commercial relations that foreign exchanges would lie against the borrowing country ; and, in such a case, the country can only maintain the normal amount of circulating medium through the exportation of credits. The imported commodities would be paid for by exported bonds and, for a time at least, a country might secure its supplies without influencing to any great degree domestic prices. While the country is in a state of transition from peace to war, this is a consideration of no slight importance.

This advantage of foreign loans appears more clearly if we notice what kind of goods will probably be imported. Thus the loan may be paid in goods that can be directly used for belligerent purposes—as arms, military equipments, and the like. This simply means that the government employs foreign labor to supply its wants, and induces foreign capitalists to foot the bills; and, if the enterprise undertaken by the state draw large numbers of men from ordinary pursuits, the fact that they are supported by foreign labor will relieve domestic industries of this charge. But the relief thus experienced will be as great, though perhaps not as direct, if goods of ordinary consumption are purchased by the proceeds of bonds. The nature of the question is the same in either case. Goods of ordinary consumption may fail in their supply because the government has diverted labor from its accustomed lines of activity. Industrial disturbance is inevitable when a people undertake belligerent operations, and the question to be decided is, whether the labor remaining in ordinary occupations shall be re-distributed, thus intensifying the industrial disturbance, or whether the country shall for a time relieve itself by employing foreign labor, and thereby run in debt. In case the latter alternative is adopted, no excessive burden is thrown upon domestic industries, the community is conscious of no want, and prices are uninfluenced by the financial policy of the government.

This interpretation of the relation between foreign borrowing and domestic industries is fully borne out by reference to the table of trade statistics for the United States during the period of the late civil war, presented on the following page.

For our present purpose it is right to regard the exportation of gold in the same light as the creation of a foreign debt. This is true because it was made possible to spare so much gold from circulation by the fact that part of the public debt was so shaped as to serve the purposes of domestic money. The commercial results were the same as though bonds to an equal amount had been placed on the

Table showing the Excess of Exports and Imports, and the Excess of Exports of Bullion over Imports of Bullion, in the United States from 1861 to 1868.¹

	Excess of exports	Excess of imports.	Excess of bullion ex- ports over bullion imports.
1861.....	\$69,756,000	.....
1862.....	\$1,318,824	.....	\$20,472,000
1863.....	39,871,000	54,572,000
1864.....	157,609,000	92,280,000
1865.....	72,716,000	57,882,000
1866.....	85,952,000	75,843,000
1867.....	101,254,000	88,797,000

foreign market and the gold retained in circulation. It appears, therefore, that the full extent of assistance rendered by foreign peoples to this government, for which a debt was created, is measured by the gold exports added to the excess of values imported. It has since been necessary for the United States, in order to bring home her bonds placed abroad, as also to again gain possession of her portion of the world's gold, to give back capital equal to that received during the war. This was accomplished by causing her exports to exceed her imports.

The practical conclusion, then, respecting foreign loans, seems to be that if a government desires to maintain the industries of the country *in statu quo*, while at the same time steps are taken which tend to disturb existing industrial relations, it must see to it that the proceeds of its loans are brought from abroad. One must not, however, on this account, assume that public loans should always be placed on a foreign market, or that a government should never so condition its bonds as to absorb domestic capital. It may be wise to break up, for the time being, the usual course of industries. The exigencies of the case may require that home labor should be induced to exert an energy greater than it normally exerts; for such a purpose, if borrowing be resorted to at all, it is home borrowing that commends itself to the

¹ Nimmo's "Report on Commerce and Navigation," 1882, pp. lvi, lvii.

financier. But, understanding the natural working of foreign loans, it must be left to the peculiar conditions of each case to determine when they shall be used.

We enter upon a more difficult part of our task when we undertake to trace the industrial effects of domestic loans. No great reliance can be placed upon personal experience with commercial credits in judging of public loans, for certain essential differences exist between the state and a private person as borrowers of money. The credit of a state is based on sovereignty, that of an individual rests on some material guarantee, or on known personal traits of the borrower. Governments can not tell when an extraordinary demand for money may be arrested; the demand of individuals is strictly limited. The debt of a state is supported by taxes; that of individuals or private corporations may be paid out of profits which spring from the investment of the proceeds of the loan. It is true the proceeds of a public debt may, in like manner, be profitably invested, yet in such a case commercial rules do not usually apply to government industries. But the greatest difficulty in tracing the industrial effects of public borrowing springs from the fact that these effects are not constant, but vary with each new step taken in the development of the loan policy.

When a government undertakes to meet a long-continued demand by the use of credits, every loan contracted changes the conditions for every succeeding loan, so that what is observed to be the effect of the first can not be accepted as a sure indication of what will result from the second or following loans.

Between the inception of a loan policy as set on foot at the beginning of a war, and its final collapse with the fall of public credit, there are three distinct steps which it is possible for a government to take. These steps are arbitrarily marked, according as the rate of interest paid is normal, high, or excessive. But though arbitrary in their presentation, the industrial results observed are clearly defined. The reason is that different funds of capital are moved according to the

different strength of the motives offered by the government to secure money. Let us then seek to trace the industrial effects of the loan policy, first, when money may be secured by offering normal rates of interest; second, when unusual rates must be offered to secure the requisite funds; and third, when the government finds it necessary to give excessive rates of interest.

Loans secured at normal rates for money.

A public loan which offers only the normal rate of interest can not exert any decided influence upon established industries, for there is no motive presented to one whose capital is well invested to withdraw any part of it from its accustomed employment and place it at the disposal of the state. It follows then, that industries engaged in profitable employment at the time of the placement of the loan will continue to exercise their accustomed degree of activity, and to maintain the usual relations between capital employed and labor directed. This must be admitted when we recognize the source from which such a loan will be filled. The only fund that can be influenced by the offer of usual inducements is that which is on the lookout for investments. This is what is technically known as the fund of capital entirely free. Employed capital will not be placed at the disposal of the state. The government can make no use of fixed investments, while the proprietor of such investments can not spare the circulating capital needed to keep them in a profitable state of activity. There is no inducement offered to one so situated to subscribe to a public loan, and consequently there is no danger that a loan which pays only normal returns on money will cripple established industries. If filled at all, it will be filled from that fund of free capital which would otherwise have been invested in new industries. Its full effect is to check further industrial expansion, and this it does by turning the energy of the country into other channels. In case, then, of a sudden emergency calling for increased public revenue, there is much to be said in favor of resorting

to loans, provided the loans may be placed at reasonable rates.

It is sometimes said in this connection that the placement of a loan induces men to save, and for this reason public borrowing is not altogether an evil. It may be there are some people who have such confidence in government bonds, and such fear of private securities, that they will buy a bond with greater pleasure than invest in common stocks. This is true of the French and possibly of the Germans; but the consideration is of slight importance for England or for the United States. Those conditions which lead men to private saving are not changed by the offer of public bonds at normal rates of interest, and it is doubtful if such a result may be relied upon in countries where private credits are well developed.

Another popular conception is forced upon our attention at this point. It is quite generally assumed that a demand for capital by the state tends to raise the rate of current interest, and that this rise is due to competition between the government and business men for control over the country's fund of free capital. The demand of the state, it is claimed, is in addition to the ordinary demand, and this is why the price of capital rises when a representative of the state appears on the market. The completeness of this explanation may be doubted, and its truth also, unless its statement be very carefully guarded. Other causes may be mentioned for the rise of interest which frequently follows the placement of public bonds. The stability of a government is likely to be the most seriously questioned just at the time of its greatest financial necessities, and on this account investors will demand a little extra payment by way of insurance. Every person, also, who has had extended dealings in money, contracts a habit of thought which naturally controls his investments. It is like starting a wagon out of a rut to bring him to think of lending to the government, and for this reason the government may find it necessary to increase slightly its offers. These considerations tend to affect the rate of interest on government paper.

But how does the matter stand with this "extra demand" for capital? There has been a vast amount of loose reasoning upon this point. The essential distinction between the state and the individual has not been kept clearly in mind. The fact is that the government desires capital for the purpose of maintaining and directing labor, and no more capital is required to supply the total labor of the country with the necessary means of subsistence when directed by the state, than when under private or corporate control. Whence, then, arises any extra demand? How does this competition come about which is said to raise the rate of interest? We must surely go deeper into the analysis than to refer thus loosely to the law of supply and demand.

This slight rise in the rate of interest which follows upon the placement of a public loan, so far as not already accounted for, finds its final explanation in the peculiar nature of profit and interest, and the relation in which they stand to each other. The most simple conception of interest is that it is payment for the hire of capital; while profit, on the other hand, is self-payment for the management of capital. It does not then necessarily follow that the rate of profit and interest fluctuate together, for they are not dependent upon the same antecedent conditions. Our attention was above drawn to the fact that, in contracting a loan, a government may be obliged to pay something above the market rate, on account of the prejudice which capitalists quite generally feel against breaking their accustomed course of investments. This prejudice affects the choice of men as capital owners. But there is another influence closely allied to this, working in the same direction, which appeals especially to that class of industrial agents known as undertakers. It is the members of this class who pay themselves, in the form of profits, for their personal oversight in the management of capital. But the rate of this payment varies with the amount of capital controlled, and on this account there is, among successful business men, a constant desire to enlarge their business. It is also true that the possible extension of established

business is limited by the amount of capital in the country's free fund. Here, then, arises a conflict of interests between the business men and the government, which has a tendency to raise the rate of public interest. The state desires to gain control over the fund of free capital; the undertakers desire to accomplish the same purpose, for otherwise it will be impossible for them to extend their own self-employment by which alone their self-pay may be increased. If the state insists on getting the money, it must in some manner induce the managers of capital to forego their prospects of increased self-remuneration, and, if no other argument can be brought to bear, the government will be under the necessity of increasing slightly the rate of interest.

Let us now come back to the question from which we started. Will the placement of a loan by the state, which does not extend beyond the absorption of the country's fund of free capital, tend to raise the rate of interest through competition for capital? Again it must be said that one's conclusions in this study are hypothetical. If the conditions of the country at the time a loan is made are such as to encourage an extension of private enterprise, then the loan will be felt in the rate paid for money. But if the state of the market is such as to depress business hopes, to render calculations uncertain, and to discourage rather than encourage industrial managers (facts which usually present themselves at the outbreak of a war, before belligerent conditions are fully established), undertakers will be fully satisfied to maintain established conditions. This being the case, they will not compete with the government in the placement of its loan. During this period of business uncertainty, then, if the government has a strong and decided political policy, it can assume control of the country's fund of free capital and yet exert no influence upon the market quotations for money. But, however this may prove to be, the conclusion already stated calls for no modification. The effect of a loan that extends no further than to draw to the disposal of the state the fund of free capital in the country, does not tend to disturb exist-

ing industrial conditions. Its influence is prospective; it tends only to check normal development.

Loans secured at high rates of interest.

Suppose now that the government, being in want of more capital than can be secured by an offer of normal inducements, determines to raise the rate of interest, or, what amounts to the same thing, to sell its paper below par. In so doing, it takes what may be termed the second step in the development of the loan policy. How do the industrial consequences of such a procedure differ from those already portrayed? The unusual inducements will, in all probability, lead men to respond to the appeal of the government, thus giving over to the service of the state capital properly regarded as lying outside the free fund. The effect of such borrowing can only be determined when it is learned from what source this newly presented capital is drawn.

There are three sources from which the state may hope to secure funds, over and above those susceptible to an offer of normal inducements. Thus, in the first place, the government may expect something as the result of savings in personal expenditure, and here for the first time is it possible to trace a direct connection between public borrowing and industrial affairs. Any general movement of this sort among the people will certainly disturb the established distribution of labor. For if people cease to use certain classes of commodities, laborers must cease to produce them. Such a change in general demand, if sudden and extensive, and if unattended by new demands for labor in other lines of activity, will lead to serious results. It involves the temporary embarrassment of those thrown out of employment, which, in its reaction, will be injurious to all industries. But counteracting influences will probably make their appearance. No government whose administration is under the direction of sound rules of finance would enter upon this second step of the loan policy, had it not taken in hand some matter calling for men as well as capital. The result,

therefore, of any general saving in personal expenditure would be, that those who before had employed men to serve themselves, would now support an equal number of men in the service of the state, receiving therefor from the state a promise of future payment. The fact that the state is willing to employ the labor set free as well as to borrow the capital set free, obviates that strain which otherwise would be thrown upon industries by the sudden change in demand. So far considered, then, this second step in loan-contracting is followed by no immediate industrial consequences of a serious nature.

In the second place, capital may be secured through the abandonment of certain industries which, before the appearance of the state upon the money market, were on the verge of paying no profit; or from a temporary suspension of certain industries which a change in demand has rendered unprofitable. It is easy to understand the manner of accomplishing this, if one but calls to mind that industrial property is always held either in the form of a "plant" or of subsistence fund.¹ The former is that which remains from some past investment of capital, as, for example, machinery; the latter is free in form, but applied in the sense that it is set aside to maintain past investments in a profitable state of activity. The rate of return from any enterprise is estimated upon the basis of these two joint funds, and, if this is observed to stand lower than the common rate of interest in the community, there are presented inducements for a change of business. But any change involves sacrifice upon the capital invested in the plant, and, in consequence, no proprietor will give up an established business until the hope of increased return upon the freed capital overbalances the loss from the abandonment of the invested capital. It is possible, then, to say that so much of the country's subsistence fund as is devoted to maintaining industries on the verge of

¹ To render this statement strictly true, it will be necessary to say that it does not apply to land conceived as "industrial property."

profitless activity is potentially free; and that a slight rise in the rate of interest offered will give to the government control over such capital. The details of this operation are that a man, under the conditions assumed, will sell his buildings to serve some other purpose, will sell his machinery for what it will bring, will sell the goods produced during the last period of industry, and place the proceeds at the disposal of the government. The reasoning is altogether the same for him who suspends an active business until the return of "better times." It may be that he was engaged in producing those things which others cease to consume when they determine to curtail their personal expenditure, and he knows that the demand for his products will return when the occasion for personal saving has passed away. He does not, therefore, as in the former case, dispose of his machinery and buildings for what they will bring, but simply closes the doors and waits the return of the usual demand. Meanwhile, he invests the proceeds of the last lot of goods produced in public bonds, believing that the premium which these bonds will ultimately pay will compensate his immediate loss. The labor which he has been accustomed to employ is likewise available for the use of the government. Such, then, is the relation existing between industries and public borrowing, when the capital secured is drawn from an unprofitable or a suspended business. Whether or not such financing is defensible, depends upon the alternatives offered to the minister of finance.

The third source from which government loans may be filled, when the second step in loan-contracting has been entered upon, is created by the increased intensity of industrial energy on the part of the paying industries. But what are the paying industries? To understand this subject properly, it is necessary to know the order in which economic wants are developed; for the permanency of wants is in inverse order to their development. Wherever there is a healthy distribution of products, any general curtailment of personal expenditure will first make its appearance in connection with

the so-called luxuries of life.¹ Below these stand the comforts of life. In the advent of a war which results in a change in the nature of the peace demand, it is the industries producing the luxuries that are obliged to suspend operations; those supplying the necessities are permanent. More than this also is true. The demand for common products will be increased by passing from a condition of peace to a condition of war, for some of those then working for the state will be better supplied than when in private life, and others will be obliged to consume commodities of the more common sort. Such industries then will not only be permanent, but will find motives for increased activity.

It is stated by Mr. Mill as a general proposition, that the industry of a people is at any time limited by the amount of their capital.² This is certainly true. Capital is subsistence fund.³ But Mr. Mill is careful to add that the industries of a country do not always reach the limit set by the amount of capital held. It is an error to conceive of industry as a simple conception; it is, rather, to borrow an expression from mathematics, a force of two dimensions. It is quantity of labor multiplied by quality of labor. Its true measure is product. It is, therefore, impossible to say that industries have ever reached their highest possibilities upon the basis of such capital as a country at any time possessed, for this would be equivalent to saying that genius for invention had exhausted itself, and that organization of labor had at-

¹ This subject of the development of economic wants is an extremely intricate one. It may be that the position here assumed will be criticised, because it often occurs that during a war consumption of luxuries increases. The explanation of this is, that an appreciation of the comforts of life is of slow development. It requires culture. But luxury consumption permits ostentation, and the only use to which one who has spent thirty years in poverty can put riches is that of display. The appearance, then, of luxury consumption during the continuance of a war is quite conclusive proof of some disturbance in the ordinary distribution of products. It means that uncultured men are getting rich out of the country's disaster. There are some interesting suggestions bearing on this subject in Roscher, "Political Economy," book iv.

² Mill's "Principles of Political Economy," book i, ch. v, § 1.

³ Jevons's "Theory of Political Economy," pp. 214, 215.

tained perfection. But, on the contrary, experience allows the conclusion that increased product always responds to increased motive. The only question, then, as to the effect of a rise in the rate of government-interest is, whether such an inducement is of the sort to which industrial managers will respond, and this is answered affirmatively by the annals of certain great periods of loan-contracting. If the conditions are such that the increased supply of commodities will not result in a fall of their price, general business will display increased activity in order to supply the state with such funds as it demands; and these conditions are met if we suppose a government to have taken the second step in the loan policy, to make headway against the financial exigencies of a great war. It thus appears that the government may hope to secure subscriptions to its loans from those engaged in active industry, and that the source from which these subscriptions will be paid is the result of intensified labor.

The economic principle upon which one relies for the truth of this conclusion is that part of the so-called law of supply and demand which happens to be true. The truth in this law is that demand precedes supply, and that, given a clear and definite demand, there will be a supply. This is nowhere more clearly perceived than in the history of inventions. Like pork or cotton, a supply of inventions follows a general recognition of their demand. This is shown by the history of the textile industries. But the most pertinent illustration, because it has to do with the changed conditions introduced by the advent of a war, is found in the influence which the outbreak of the rebellion exerted upon the development of agricultural machinery. Labor was withdrawn from agricultural pursuits to follow the fortunes of war, but the demand for agricultural products was as great as ever; in this manner the need of new machinery made itself felt, a need to which the inventive genius of the American people quickly responded. The language of the report of the Commissioner of Patents for 1863 is pertinent to the question in hand. He says:

"The most striking fact connected with this class (Class A, Agriculture) is the rapid increase of applications filed. Notwithstanding half a million of our agriculturists have been withdrawn from the farm to engage in military service, still the number of applications for patents on agricultural implements (exclusive of reapers, bee-hives, horse hay-forks, and horse hay-rakes) has increased from three hundred and fifty in 1861 to five hundred and two in 1863. At first thought such a result would seem an anomaly, but it is this large drain upon the laboring classes which has caused a greater demand than usual for labor-saving machinery. . . . Machines for sowing and planting seed are the most numerous in this class, and they have been brought to such a state of perfection that one can now be supplied with those that plant everything, from a mustard-seed to a potato, either by hand or animal power, at prices varying from one hundred dollars down to two dollars and fifty cents."

The commissioner then continues the description of the agricultural inventions of the year, and says, in conclusion :

"Indeed, throughout this entire class there appears to be an increased activity in the effort to substitute labor-saving machinery for manual labor, and, judging from appearances, with the most beneficial results."¹

Loans secured at rates of interest abnormally high.

As contrasted with this second step in the placement of public bonds, which is characterized by a rate of interest slightly above the normal rate, the government may be said to have taken the third and last step when it offers abnormal inducements to secure control over capital. For example, England, at the time of the Napoleonic wars, as also the Federal Government during the late rebellion, entered upon this third stage of deficit financing. In both instances the governments sold their paper at heavy discount. The evil consequences of offering excessive rates of interest for money are two. In the first place, it tends to dry up the source of income upon which the treasurer must rely in the future; and in the second place, it results in a saving forced from the laborers, the benefits of which the laborers do not enjoy.

¹ "Patent-Office Report," 1863, vol. i, p. 21.

That is to say, under the industrial conditions introduced by public borrowing at high rates, the employers have it in their power to force their workmen to live on less than their usual allowance, and with the difference to buy bonds in their own name. Let us look a little more closely into these results.

It has been already explained how that those industries on the verge of bearing no profit were abandoned in consequence of increased returns from investment in government paper. But this idea of normal profit is altogether arbitrary. It depends at any time upon the alternatives presented to him who desires to invest capital, and the conditions which serve as the basis of his calculations must change with every successive rise in government interest. Thus, suppose the normal rate to be 5 per cent, and the government to offer 7 per cent. All industries upon the verge of the profit line when interest was 5 per cent will free their capital for the use of the state; but now 7 per cent, or some rate between 5 and 7, comes to be the established market rate, and the consequence is that other industries are in this manner brought into the same relative position, so far as profit is concerned, as were those industries which felt the influence of the first rise in government rates. If, now, the rate be again advanced, these in their turn will be given up, and so on for every successive increment in rate.¹

In this manner there is established within the community a class living out of the proceeds of taxes, who are yet not of necessity actively engaged in current production. They were originally constant producers and tax-payers; they are now at liberty to become idlers and tax-receivers. Although the fiscal demands of the government remain as great as be-

¹ It is not true that all such industries will disappear. A sufficient number only will place their freed capital at the disposal of the government that the diminished product will enable those remaining to realize a higher profit. Such persons will not abandon their business. Nor will those engaged in supplying the necessities of life turn their capital to the control of the state, for they are in a position to demand a higher price for their products, and so secure to themselves the benefit of an advance in the rate paid for capital.

fore, it has deprived itself of the assistance of certain of its subjects. It is in this manner that excessive appeals through loans tend to dry up the source of revenue upon which the state must rely. Indeed, a government entering upon this third step in loan-contracting is in the position of a man who consumes his capital in running expenses ; it is only a question of time when it will reach the end of its financial resources.

But how does this matter stand with regard to the wage-receiving class ? The quite universal testimony of history is that any great industrial disturbance rests most heavily upon those who, possessing no property, depend for an income upon their daily labor. It makes no difference whether this disturbance arise from a disordered currency, from interrupted commerce, or from an excessive appeal on the part of the state for revenue—it is the wage-receiving class that feels most sensitively the change. Avoiding all controversy upon the doctrine of wages, it will be sufficient to call attention to the order in which inflated prices find their way into the quotations of various commodities. The argument thus implied is easy of comprehension. Since all goods are not equally sensitive to those influences affecting price, it follows that such commodities as are most tardy in their advance must be at a relative disadvantage when exchanged for other commodities. A general rise in price, therefore, must be to the detriment of those goods the last to move.

What, then, is the order in which commodities respond to those influences which effect a general rise in prices ? Upon this question also we may avoid tedious discussion, for on one point, at least, there can be no difference of opinion. Wages always follow, upon a rising market, the price of those commodities from which laborers subsist. From this it appears that when a general rise in prices takes place, wages at the old rate must be paid for goods at the new and higher prices, which means that real wages decrease because of the tardy rise in nominal wages. We may then clearly understand how a financial policy which results in the rapid

inflation of general prices must work to the injury of those who depend upon wages ; and we may also easily trace the source from which government loans are filled under such conditions. It is the employer who buys the bonds, but he pays for them out of his extraordinary profits, and these profits he secures by a reduction of real wages. That is to say, he sells for the new and higher prices goods which were produced at the old rate of wages. A financial policy which leads to such a result is open to the most severe criticism of which the science of finance admits. Not only does it take from the public at large more than is received into the treasury, but it coercively deprives one set of citizens of a part of the product of their labor for the benefit of others.

The history of England from 1790 to 1815 supports the opinion here expressed, and presents a most pertinent illustration of the burdens thrown upon the laboring classes by a vicious policy of treasury management ; but quotations from American prices during our late war will serve the purpose equally well, and it is proper to remember that criticism, like charity, should begin at home. Mr. David A. Wells is a most careful statistician, and, with the machinery of the United States Government at his control for investigation, he arrived at the following conclusion : " Up to the commencement of the year 1867, the general effect of the agencies growing out of the war had been to occasion an average advance in the price of commodities to the extent of about 90 per cent, while the corresponding average advance in wages was not in excess of 60 per cent."¹ This statement is capable of a simple though a somewhat startling interpretation. It means that the loans contracted during the late war were in part filled from the coerced savings of the laboring classes. The new source of revenue opened when the Government offered the excessive inducements for the loan of capital, was created by a fall in the rate of real wages.²

¹ "Report of the Special Commissioner of the Revenue," 1868, p. 14.

² That each may see for himself that the commodities upon which Mr. Wells has based his calculations are necessities, the following table is inserted, which

It thus appears that when the policy of public borrowing is carried to an extreme, it works, in one respect at least, like a tax; for they who curtail their personal expenditures, that the demands of the government may be met, do not do so willingly, but are forced to make the sacrifice. But, from another point of view, such borrowing is unlike a tax, for the payment is not final as between the government and those citizens with whom the government directly deals. The collecting agent is not a public officer, who receives a fixed salary for his services, but the employer of labor who receives a commission in the form of public bonds equal to the full amount of capital collected, plus whatever premium the distress of the government permits him to secure. Thus such borrowing works as a tax that entails the necessity of a new tax, equal at least to the full amount of the sums secured. Its practical effect upon the laboring classes is to coerce from them a part of the product of their labor, which sum the government accredits to their employers. We may not on this account censure any individual employer, for,

shows the average price of some of the leading articles of domestic consumption, and in house-rent, in 1867, as compared with 1860-'61, in the manufacturing towns of the United States. Cf. Report of 1868, p. 15:

ARTICLES.	Per cent increase of 1867 over 1860.	General averages.
Flour and other breadstuffs.....	92	
Meats—fresh and salted.....	86	Average increase for provisions is 86 per cent.
Butter.....	91½	
Fish—dry and pickled.....	74	
Potatoes and other vegetables.....	79	
Beans.....	92	Average increase in price of domestic clothing is 86½ per cent.
Sugar and molasses.....	88	
Tea.....	99	
Coffee.....	117	
Milk.....	61½	
Fuel—coal, wood, etc.....	57	General average increase in cost of provisions, clothing, rent, etc., to men with families, is
Domestic cotton goods.....	98	
Clothing.....	75	
House-rent.....	65	75 per cent.
Board for men.....	71	
Board for women.....	81½	

under the pressure of competition, his liberty of action is not large ; it is the pernicious financial policy adopted by the administration that should be held responsible. The results portrayed are the necessary consequence of an excessive appeal to public credit. A diminution of real wages must always follow at the heels of such financing.

The general conclusion of the foregoing analysis is as follows : Public loans influence industrial affairs through the medium of capital, but the character of this influence depends upon the nature of the loan, upon the conditions under which it is contracted, and upon the fund of capital from which it is filled. So long as the placement of a debt by the state does not affect the market quotations of commodities, the full extent of its influence is to divert capital, which might otherwise have gone to extend existing industries, to the purposes of the government. But the moment the state offers unusual inducements, the price of commodities is thereby affected. Future loans must on this account be contracted on a rising market, and by taking this step the government enters upon a policy which contains the germ of industrial disturbance and social injustice. Moreover, such a policy is suicidal, for it tends to dry up the source from which all revenue must be derived. At the same time, it must not be forgotten that there is a wide margin between a slight increase of the normal rate of interest and an offer of excessive inducements ; and, although the industrial and financial principles are the same in either case, the practical results may be very different. It is, therefore, impossible to determine how far a government is justified in raising the rate on public bonds, unless the probable results of this method of securing money be compared with what must follow from running the taxing machinery at a higher rate of speed. It is sufficient for the present to learn the manner in which public borrowing is related to industrial life.

CHAPTER V.

WHEN MAY STATES BORROW MONEY ?

OUR study in the foregoing chapters has led to the disclosure of many tendencies, dangerous to the highest welfare of organized society, which seem to be a necessary part of the borrowing system. But governments may not, on this account, be reasonably prohibited from the employment of their credit. The only practical importance of such a disclosure is to suggest the necessity of further inquiry respecting the conditions under which an appeal to public credit may be justified.

It must be noticed at the outset, that this inquiry can not be safely undertaken as an isolated question. Governments do not borrow for the sake of borrowing. The necessity of obtaining money is always an assumed premise ; and it is upon this premise, and in view of the alternative presented of borrowing money or levying taxes, that financial writers defend an appeal to credit. And it may be added, further to simplify the question, that the minister of finance has nothing to do in determining the nature, the time, or the extent of the demand made by the government upon the public treasury. If the government wants warming-pans to send to the South Sea Islands, it is his business to supply the warming-pans in the most economical manner possible.

There are many publicists who write against public debts as though the question were one of appropriation or no appropriation, whereas, in reality, the question is one of debt or taxes. The study of the present chapter proceeds upon

the assumption that the demands of the government for money are just; otherwise neither a loan nor a tax is capable of defense.

Let us then inquire under what conditions deficit financing may be justified. We need not burden our study with an attempt to enumerate all the cases in which credit may be with propriety employed; our purpose will be better served by some classification from which the principles involved may be discovered. Such a classification is the following, disclosing as it does the conditions in which convenience, necessity, or public economy demands the use of public credit.

1. A want of coincidence between estimated and actual revenue, if the error come in the form of a deficit, calls for a temporary loan.

2. The advent of some unforeseen financial emergency, as war, famine, fire, flood, and the like, when the government is called upon to act promptly if at all, is regarded as a just occasion for a resort to the money market.

3. A determination on the part of the government to undertake some public work of such a nature that some considerable time must intervene between its beginning and its completion, presents a necessity for the employment of state credit. The cases here set forth must be subjected to separate analysis.

Loans may be used to cover a temporary deficit.

It is no occasion for surprise or censure that the close of a fiscal year shows calculations respecting income and expenditure to have been incorrect. It is seldom the case that a budget as executed harmonizes with a budget as estimated. This, indeed, can not be expected, for many of the elements that enter into the calculation are entirely beyond the control of the financier. Even with regard to revenue, the factors are not subject to precise estimate. The proceeds of a poll-tax may be calculated with some degree of assurance. The same may be said of a land-tax, or even of an income tax, provided it has been long established. But indi-

rect taxes of all sorts depend for their efficiency upon the general trade of the country. The revenue arising from customs duties, for example, is determined by the amount of dutiable goods imported, which in its turn depends upon the character and extent of general trade. Elements of uncertainty, therefore, are necessarily introduced into the framing of the budget, even upon the side of revenue.

Questions of public expenditure lie also beyond the direct control of the financier. The rule according to which a private individual manages his personal expenditure is entirely reversed in matters of public finance. The question is no longer how expenditure may be kept within a fixed income, but how income may be brought to coincide with a given rate of expenditure determined upon. It frequently occurs that some change in established policy involves increased expenditure, and that this new demand must be immediately met. If this increased expenditure bids fair to call for a continuous annual payment, it is wise to levy taxes equal to the new and constant demand; yet in this case, money must in the first instance be borrowed, for new taxes can not become immediately productive. On the other hand, if the expenditure is likely to occur but once, industries will be less disturbed by securing the necessary money through loans, with provision for gradual repayment, than if a large sum be taken in a single year through an increase of taxes. It seems, then, that both convenience and economy justify the use of temporary debts, whenever estimates fall short of actual expenditures, or when some change in public policy presents new demands to the treasury department that must be immediately met.

But the real question that lies at the bottom of the policy of temporary loans goes deeper into the science of finance, and suggests itself only when we inquire respecting the alternative presented to the administration, supposing the policy of temporary debt to be discarded. The alternative is to overestimate expenditure and underestimate revenue, in order that such discrepancies in the budget as may arise should

always be on the side of a surplus. The question, then, reduces itself to this: Since perfect harmony in the budget can not be expected, do sound rules of finance require the error to fall on the side of surplus or of deficit? According to the maxims of domestic economy, a constantly-recurring surplus is accepted as evidence of good financiering; but it is doubtful if such maxims are applicable to national affairs.

There are three reasons, as it appears to me, why a constant deficit should be chosen rather than a constant surplus.

In the first place, the moral effect of a deficit upon the electors as well as upon the legislators is good. The people will be more careful to exercise their constitutional prerogative in the control of expenditures if the minister of finance is obliged to use the language of poverty, than if they are made to feel rich by the portrayal of an ever-increasing surplus; the legislative body, also, will be more careful as to appropriations, if deficits stare them in the face, than if their deliberations are carried on in the presence of an overflowing treasury. There can be no more pertinent testimony to this claim than that presented by the history of the United States Congress during the last few years. Resting secure in the carelessness of a people conscious of being rich, and having at their disposal an enormous revenue, our national representatives have made appropriations which would have caused the downfall of any party had those appropriations rendered necessary an appeal to taxes, or even a resort to temporary loans. The peace expenditure of the year ending June 30, 1860, was \$77,000,000, of which \$17,000,000 went to the service of the public debt. Exclusive of the debt service, there was an expenditure of \$60,000,000, while the gross income amounted to \$81,000,000. Place this budget by the side of that of 1882. At this latter date, the gross income amounted to \$408,500,000, while the expenditure for ordinary purposes amounted to \$257,500,000, leaving a surplus of \$145,000,000. In this ordinary expenditure there is included the debt service of \$71,000,000, which, being deducted, leaves \$186,000,000 as the cost of the present peace establishment. It is this sum

which comes properly into comparison with the \$60,000,000 of 1860. There thus appears an increase of \$126,000,000 in the ordinary expenditures within a period of twenty years. Of course, the necessary expenses of the government have been somewhat extended with the increase of population. The *necessary* pensions, also, are included in this amount properly chargeable as a legacy of the war. But every fair allowance being made, there yet remains an extension of expenditure which can only be explained by the fact that the great problem of modern legislators has been, how to spend the public moneys.¹

The claim that is here urged in support of deficit financing is especially pertinent when the machinery of taxation is used for other than revenue purposes, for, under such conditions, those interested in the maintenance of existing fiscal laws will show themselves very ingenious in finding occasions for public expenditure. It is not too much to say that the Arrearage Pension Acts, by means of which the treasury was relieved of its plethora of funds, find their true explanation in the desire of Congress to maintain inviolate the system of protective duties. This could not be done in the face of an ever-increasing surplus, and protectionist politicians did not dare to advocate the abolition of the whisky tax; it only remained for them to spend the money.

The argument may be reduced to this statement. The full realization of self-government requires a delicate adjust-

¹ The full strength of this late tendency toward an extension of expenditure is more perfectly exposed if we take into view a longer period for comparison. The following table presents the pertinent facts as they appear since the close of the second war with England.

A. D.	Ordinary expenditure.	Percentage increase.	Average annual increase.
1818.....	\$21,000,000		\$500,000
1828.....	31,000,000	50	1,820,000
1860.....	60,000,000	100	
1882.....	186,000,000	210	5,725,000

ment of budgetary machinery, but surplus revenue acts as a weight which throws that machinery out of balance. Close estimates, even though they lead to deficits, are essential to good treasury management.

But, in the second place, a deficit at the close of a year brings for a second time before the legislative body the appropriations of the year previous. A revisionary study of all expenditures is in this manner rendered necessary, and this tends to secure a stricter control over future appropriations. The laws of many states provide for temporary loans, sometimes in the form of a loan from one appropriation that is in excess to another in which there occurs a deficit, sometimes the government is authorized to appeal directly to the market; but in either case the action of the minister of finance must come up for approval or disapproval when his report is presented to the legislative body.

The third claim in favor of deficit financing is of a somewhat different nature, since it brings to our notice the commercial distress which may be occasioned by adopting the competing policy. It is a well-known principle that the value of money is inversely as its amount; and if, through a constant excess of revenue over expenditure, large sums are withdrawn from circulation; or if, through any considerable excess in the revenue of one year, the average amount of money in the hands of the people be reduced, the country will suffer the inconvenience which always attends falling values. It is true that market quotations will not be influenced unless the withdrawal of money continue for some considerable time; but one can not on this account deny the pertinency of the criticism, for the evils of a contracting currency are felt long before they are registered in general prices. A good monetary system is like a strong fence about industries, and should be guarded with solicitous care, lest industries be thrown open to unusual influences. In case the government adopting the policy of surplus financing is liable for the payment of a large debt, the evil consequences we have suggested need not necessarily follow, for

the revenue in excess of current needs might be used in payment of its obligations. Such an employment of money would have no more influence upon prices than when used in the course of ordinary business by a corporation or by a private person. It is also true that the government might deposit its surplus with banks, and in this manner return the money to circulation. Without attempting a discussion of this proposal, it will be sufficient to suggest that the experience of the United States during the Jacksonian period, when such deposits were made, gives little encouragement that such a plan would work to the advantage of the public.

For such reasons as these the policy of systematic deficits is believed to be in more perfect harmony with sound rules of finance than the policy of a continuous surplus. It renders fiscal machinery more sensitive to the demands of constitutional government; it brings appropriations a second time under the scrutiny of the legislature; and it frees industries from the fears of disturbance arising from arbitrary fluctuations in money amount. But, if we admit the necessity of deficits, we commit ourselves to the defense of temporary loans; and the only danger that lies in such a policy is that the temporary debts should be converted into permanent obligations. Against such a tendency the financier should be ever on his guard.

Loans may be used to meet a fiscal emergency.

Following out the classification already suggested, we come now to consider a fiscal emergency as occasion for the employment of public credit. A fiscal emergency may be said to have arisen when the government must not only have money, but needs the money at once, in order to avert an impending calamity. Thus, threat of foreign invasion, or some unforeseen disaster, may be the occasion of such an emergency. Under such conditions, it is claimed that a government is justified in selling bonds to secure the needed capital. This justification rests upon two considerations:

1. On account of the pressing nature of the demand, the

administration can not wait until the proceeds of new taxes swell the treasury fund.

2. Any measures which a government might take to provide against possible emergencies are bound up with greater financial evils than are entailed by the loan itself.

As regards the tardy movement of newly levied taxes, there can be no question. Some considerable time is required for a new fiscal law to become operative, and several years must elapse before a new tax can reach its highest degree of efficiency. The history of direct taxation in the United States serves as a good illustration of this fact. The first attempt to raise money in this manner was legalized by an act of 1798, but the treasury reports for two succeeding years fail to show from it any return. The Jefferson government received the greater part of the revenue of which this tax was the source—a government, it will be remembered, that embraced the first opportunity to effect the repeal of the law.

Again, on the occasion of the war of 1812, a direct tax was levied. This is especially pertinent to the question in hand, for, in this instance, a revenue system was established to meet an emergency. This system, however, did not become productive until the second year after its establishment, and it reached its highest efficiency in 1816, after the pressure upon the treasury had passed. The entire system of internal duties, established during the late war, testifies to the same fact. It did not get fairly under way till the latter part of 1863. The total amount of income for the four years previous to April 1, 1865, was \$314,000,000; but during the four years subsequent to this date the system of internal duties brought into the public treasury \$967,000,000. This expansion can not, as in the case of customs, be traced to an extension of trade; the true explanation is, that it takes time for a new fiscal system to become remunerative. New taxes, therefore, can not be depended upon to meet an emergency.

But why may not the government raise the rate upon existing taxes? This may be done with success provided

the fiscal system has been shaped to prepare for such a measure; but it is usually the case that existing rates are so high that an increase in the rate will not increase revenue. But, should the general tariff be below the revenue rate, it would yet be unwise for a government to entertain such a proposal to cover an emergency. All changes in rates that effect prices should be well advertised, otherwise the fiscal measures of the government will unnecessarily disturb industrial calculations. A tax might be sprung on the merchants, so as "to catch the fall trade," but such a measure does not lie among the possibilities of a reputable government. Our conclusion, then, seems to be unavoidable. When a great and sudden emergency comes upon the country, a government is justified in resorting to public credit, so far, at least, as may be necessary to cover the period intervening between the levy of new taxes and the time at which they become remunerative. The only alternative presented is to make some provision in ordinary times against possible emergencies. This brings us to the second consideration suggested above.

In the financial policies of nations, there stand forth two methods by means of which a resort to loans may, for a time at least, be obviated, even though the public treasury comes into the presence of immediate and pressing demands. These may be termed, for the purpose of characterization, the Prussian and the English method. According to the former, it is the duty of the minister of finance to lay by, during a period of prosperity, a reserve fund that may be used in time of need; while the second method endeavors to accomplish the same end by maintaining in ordinary times certain taxes at a low rate, in order that the rate may be immediately increased in time of financial stress. Are such provisions for fiscal emergencies defensible?

Considering, first, the question of reserves, it may be said that the sovereigns of Prussia, in thus maintaining a "war-chest," conserve the tradition of the founders of their state. When Frederick II came to the throne, he received from his

father a fund of 8,700,000 thalers, and at his death, notwithstanding the long and severe struggles of his reign, he left to his successor a fund of 70,000,000 thalers. This policy is the introduction into modern life of one of the most prominent features of ancient financing. "It was the common practice of antiquity to make provision in times of peace for the necessities of war, and to hoard up treasures beforehand as the instruments either of conquest or of defense, without trusting to extraordinary imposts, much less to borrowing in times of disorder and confusion. The Athenians are said to have amassed upward of 10,000 talents in the interval between the Persian and the Peloponnesian wars, and the Lacedæmonians imitated their example. A large treasure, part of which had been stored up from the age of Cyrus, fell into the hands of Alexander the Great on the conquest of Susa and Ecbatana. In the Roman commonwealth the *aurum vicesimarium*, or tax of the twentieth penny on the manumission of slaves, was accumulated, along with various sums taken from subjugated states, in the Temple of Saturn, as a sacred deposit to be used only in the utmost emergency. On leaving Italy, Pompey was weak enough, or careless enough, to leave this treasure behind him, which, in consequence, became the prey of his less scrupulous or more vigilant rival. At a subsequent period, Augustus, Tiberius, Vespasian, and all the more able emperors, were in the habit of accumulating treasure. Paulus Æmilius brought a large amount of gold and silver to Rome, which is, however, admitted to have been a part only of the wealth of the Kings of Macedon, Perseus having previously dissipated a considerable portion in his wars with the Romans. The practice, in fact, was universal in the ancient world."¹

The conditions under which ancient peoples lived, and their conception of the purpose for which states were organized, may, perhaps, secure for this policy of war-reserves, as practiced by them, some faltering words of commendation;

¹ McCulloch, "Taxation and the Funding System," p. 396.

but when one takes into view the wider range of duties now imposed upon governments, the changed methods of warfare, and especially the complexity of modern industrial relations, he is forced to conclude that the maintenance of this old theory of treasury management is without defense. Governments of to-day can not be guided alone by their military interests, for the state is more than a military organization.

Three important interests are endangered by maintaining any considerable war-reserve. Such a policy works against self-government; it leads to industrial confusion; it embarrasses sound financial administration. Constitutionalism opposes this policy, because the possession of a large sum of money makes an administration independent of the people, and renders it possible for a government to commit the country to a line of action in which there is no popular interest. It is no answer to this criticism for one to say that a reserve fund can not be sufficiently large to carry an important enterprise to completion, and that the government must at last make its constitutional appeal to the people for financial support. Control must be exercised by the people at the beginning of an enterprise or not at all. When war has been once entered upon, and the first blood shed, the administration may use that intangible something called national honor to whip a reluctant people into the support of an offensive policy. The essence of our criticism is, that preparation of this sort against emergencies renders popular control over public policy inoperative, just at the time when it is imperative that such control should be exercised.

So far as industries are concerned, the effect of a reserve fund depends largely upon the manner in which the fund is accumulated, upon its management while maintained, and upon the method of its expenditure when that becomes necessary. If obtained through conquest, or as an indemnity from a foreign country, it will not immediately affect industrial activity. If during its maintenance it be kept in the form of specie, and, when invested, it be thrown upon a foreign market, one can with difficulty trace its influence

in domestic business affairs. Or, to go one step further, if a specie reserve be spent at home, while a country is accommodating itself to belligerent conditions, it may render some positive assistance. This is easily explained. At the outbreak of a war, it is usually desirable that industrial activity should be quickened. This may be done by adding to the country's circulating medium, so as to give a slight upward impulse to the market. The objection to securing this result by an issue of legal-tender paper is, that permanent values would be thereby disturbed, and the ultimate effects of the measure would be injurious. This does not hold against an addition to circulation in the form of specie, for such an increase could effect no inflation of prices. In case the country could not absorb the additional amount of money, it would be drained to foreign countries through increased importations. There is, then, but little difference between this method of disposing of a fund of reserved specie, and its direct expenditure by the government upon a foreign market, except that its flow through the hands of domestic commerce may have assisted in that reorganization of industries always necessary when a people enters upon a war.

It is feared, however, that these considerations are a little fanciful. They assume the fund to have cost nothing, that it is composed of specie, and that the country loses nothing during a period of peace on account of the fact that the fund is idle. If it be necessary to accumulate this fund through taxation, the case is different from the beginning. There is an old financial maxim which says that it is better for money to fructify in the pockets of the people than to lie idle in the coffers of the state. As an accurate statement, this is, of course, open to criticism. Money will fructify in the pockets of the people no more than in the chest of the state. Money of itself will fructify nowhere; it has no vital principle. It is merely a machine, an industrial instrument. Yet the maxim expresses a truth, for it means that capital is lost to the people who tie their money up in war-reserves; and the profit or increase on that capital—being the added effi-

ciency to labor which the possession of capital gives—is also lost. It shows an entire misapprehension of the point to say that the fund may be employed by the government as applied capital, for, when so employed, it fails to serve the purpose of a reserve fund. It must, therefore, be regarded as unwise for any government to embarrass the industries of its subjects in order to establish a useless fund. Nor is it necessary as a military measure to make such provision against emergencies. The true war-reserve for any people consists in a healthy state of their industries. Under such conditions there will always be a large fund of free capital, and a government which has maintained its credit above reproach, entering upon a policy approved by the country at large, can avail itself of this fund through loans as easily and as quickly as it could relieve its necessities by turning the great key of a war-chest.

But, again, may this preparation for the exigencies of war be defended as a financial measure—does it harmonize with the claims of the financial interest? For answering this question, we must first learn the kind of values placed in the reserve fund, to what extent they are immediately available, and what deficits in ordinary expenditures will be uncovered as the result of their disposal. These values may be of three sorts: specie, paper of foreign governments, and industrial securities. The securities, it is fair to assume, will be for the most part of domestic origin. The composition of the reserve fund of Prussia, which in 1876 amounted to \$111,000,000, was as follows: It embraced \$30,000,000 in specie, \$16,000,000 in foreign interest-bearing paper, and \$65,500,000 in railroad securities. Now to the extent of the metallic reserve the government certainly has an available fund, and, as it bears no interest, and so can have no service depending on it, its application at the outbreak of war would create no deficit in ordinary expenditures; but so enormous are the financial demands in modern warfare, that nothing could be done with so small an amount. What are \$30,000,000 in the prosecution of a great war? The sum is

just large enough to set an enterprise on foot, and commit the people to some policy in which they may have no interest. It is futile to talk of collecting enough specie in time of peace to evade the burden of taxes when an outbreak shall occur. The minister of finance should, of all men, be the most strenuous against such a measure, for, by the collection of this fund, capital is unnecessarily exported in order to recover, for the purpose of circulation, so much specie as the government had taken up; industries are thereby weakened, and the country is thus rendered less able to bear the stress of a strong financial policy than if it had been left unencumbered by the tax.

But the full absurdity of this policy appears only when one considers the fund as composed of interest-bearing securities; for a slight analysis will show that, as a matter of fact, so far as industries, taxes, and general financial management are concerned, there is no difference between a sale of these securities and the placement of new bonds. In the first place, the source from which the government draws its capital would in either case be the same. The securities placed upon the market must be absorbed by the country's fund of free capital; that is to say, by the same fund to which appeal would be made through an issue of new bonds. Whatever industrial consequences, therefore, would follow the direct borrowing of a certain amount of capital, must make their appearance when an equal amount of capital is diverted from its accustomed line of investment by the sale of securities. Nor, in the second place, will the sale of interest-bearing securities obviate the necessity of levying new taxes. It will probably be the case that the income arising from this fund constitutes a permanent appropriation for the support of some peace service, as, for example, pensions, military schools, invalid funds, sailors' homes, and the like. Such demands do not cease because the country has entered upon a war, yet the ordinary revenue devoted to their support is cut off by the depletion of the war-chest. The government is under the necessity of making good this

deficit in its ordinary income. What, then, is the difference whether taxes are levied for this purpose or for paying interest upon newly-created bonds? The only financial question involved has to do with the most economical method of employing the proceeds of these new taxes—whether their sale in the form of an annuity will bring a larger amount of ready cash than the sale of securities held. For such a question there can, of course, be no general answer, but the probability is that strong governments, enjoying the reputation of honest dealings, will find it to their advantage to place new bonds.

It seems, then, proper to conclude that, when an emergency arises, the financial problem is not at all simplified by the possession of a large fund of negotiable securities. Indeed, in one particular is this problem rendered more difficult. New taxes never work well, unless the people who pay them feel their necessity. The friction occasioned by complaint is a serious matter to the tax-collector. Now, if the administration start with an empty treasury and borrow money, there can be no question in the popular mind respecting the necessity of the taxes, if only the purpose of the government be approved. The need of additional revenue is the same in the other case, but this will not be clearly seen if it be known that the government has a war-chest; and, in consequence, the newly-levied taxes will have greater obstacles to overcome. Thus not only are the industries of the country less able to bear taxes than if no capital had been unnecessarily taken during times of peace, but an appeal to those industries for revenue is rendered unnecessarily difficult by the presence of a war-chest.

The criticisms here presented would in part disappear should the reserve fund be composed of values that could be quickly disposed of upon foreign markets; that is to say, so much of the criticism as arises from the fact that the sale of securities at home depletes the fund of which the financier desires to avail himself by other means. It is probably true that, by sending bonds back to the people from whom they

originally came, a government may realize more than if it endeavored to place its own paper upon the same foreign market; for, other things being equal, government paper is always highest upon the market where it is issued. Such a consideration, however, extends no further than to suggest the sort of paper that should be employed if a government has determined to establish a war-reserve.

But it may be said that preparation for war in time of peace does away with the necessity of paying a debt when war shall have been brought to a close. In so far as extraordinary expenditures may be paid out of the war-chest, this is true; but it is not a final statement of the case. The question under discussion holds in view the advisability of war-reserves as a permanent policy, and if the reserve fund is for any cause depleted, the maintenance of the policy requires it to be again filled when the emergency shall have passed. There is, therefore, no difference, so far as the ultimate burden upon the people is concerned, whether the extraordinary expenditure be borne by the reserve or be met by an appeal to credit; in either case, a necessity is imposed upon the government of levying special taxes in order to recover its ante-bellum financial position. It is the most superficial of all thoughts that a war-chest obviates the necessity of war taxes.

But again it may be asked: Why can not this fund, so far as it is composed of interest-bearing securities, be made to accumulate independently of taxes, by applying its annual earnings to the purchase of new securities? It would, I think, be difficult to frame a question that suggests a larger number of financial errors than this; but for our present purpose it will be sufficient to call attention to its fundamental misconception. The question implies that the state possesses an interest independent of the interest of the people. This is not true. The state has no purpose in becoming a wealthy corporation. The first rule laid down by the science of finance is, that the demands of the government for money shall never exceed the amount necessary to per-

form with economy those duties imposed upon it. Should a government, however, possess a productive fund, the proceeds of which might be appropriated to necessary expenditures, but, instead of so using it, permit the fund to compound out of its own earnings, while other services are supported through taxation, the practical result would be the same as though the fund grew from the proceeds of taxes. The very assumption is erroneous upon which the question is based, and all that was said above respecting the establishment of a reserve fund by taxation applies equally to its accumulation by compound purchases.

We can not, then, in view of all that has been said, evade the conclusion that war-reserves are contrary to sound financial policy among commercial peoples. The true war-chest is a healthy state of industries, and the key for opening this chest is unblemished credit. If there is no other means of providing against unforeseen emergencies, a sudden and imperative demand upon the public treasury must be accepted as ample defense for the employment of public credit.

But what may be said of the English method of providing against an emergency? In theory this method, which maintains some particular tax at a low rate in ordinary times, satisfies all the varying demands of a sound financial policy. It recognizes that industries should be freed so far as possible from all restraints; that a new tax can not be immediately productive; and that arbitrary modifications of existing taxes must endanger continuous revenue. It must be admitted that the method here considered, and which we have termed the English method, is found in books rather than in practice, for it has never been followed with that strictness which gives it the sanction of a well-defined custom. As presented in the course of discussions, it is as follows: The machinery for collecting the income tax, it is urged, should be always kept in good working order, and the amount collected in times of peace should be small. With such a provision a fiscal emergency may be met by simply raising the rate. That is to say, this policy establishes a war-chest whose funds

are deposited with the people, and assigns a particular tax to serve as its key.

In illustration of the manner in which the income tax is used, we may refer to Mr. Gladstone's administration of it during the Crimean war. In 1852 this tax was 7*d.* in the pound on incomes of £150 and upward. In 1853 incomes between £100 and £150 were brought under the operation of the tax at the rate of 5*d.* in the pound, and the tax was extended to Ireland. In 1854 this tax was doubled to make headway against war expenses; and in 1855 the rate was again raised to 1*s.* 4*d.* and 1*s.* 11*d.* in the pound, respectively, for the two grades of incomes. This rate was retained through the year 1856, but in 1857 and 1858 the tax was reduced, so that it finally stood at 5*d.* in the pound for all incomes above £100. It should be said, in this connection, that Mr. Gladstone desired to carry through the Crimean war without an appeal to loans. This he did not succeed in doing, but he did succeed, by his management of the income tax, in relieving to a great degree the credit of the country.¹

There can be no doubt but this method of preparing for war in time of peace is superior in every particular to the policy of establishing a war-chest; but it is by no means certain that, in a well-ordered financial system, the income tax may not be put to better use. If any particular tax must be subjected to sudden and unexpected changes in the rates imposed, it is wise to select the tax upon incomes for that purpose, for personal consumption will alone be affected by the change. According to my own views, however, this tax is an essential part of a well-formulated financial system, and should be regarded as a source of permanent revenue. We are then led to inquire if no other method of providing against sudden emergencies may be devised. The only method coming into competition with this, regarded by finan-

¹ The principles underlying this policy were recognized by Alexander Hamilton, and this explains his desire to establish internal duties. He clearly perceived that import duties could not be relied upon in time of war.

ciers as worthy of consideration, is the one that looks for relief in the employment of temporary loans. It lies in the purpose of this policy to establish a system of taxation so broad that it may furnish adequate supplies for ordinary demands while yet the rate imposed shall be below the maximum rate. In case of fiscal emergency, this rate must be gradually raised, but the stress of the first demand may be met by temporary loans. The details of this policy are fully presented in a subsequent chapter upon the financial management of a war.

Our study, then, respecting exigency loans leads us to acquiesce in their necessity, since it appears that any adequate preparation on the part of the state against sudden demands is less defensible than a resort to credit at the time the demands shall arise. The best preparation for war is the creation of a large fund of free capital in the community, and the most economical means for the government to secure control over this fund, upon the advent of an emergency, is through the placement of public bonds. We may, therefore, deliberately, and after due consideration, adopt the policy of public debts as an essential part of a good financial administration. It is true that dangerous tendencies are bound up in deficit financing. A highly organized mechanism always brings with it the possibility of disaster. A national debt is a national evil. But he would be rash indeed who, for such a reason, would close this source of revenue, for such a decision must entail yet greater evils by forcing governments to adopt other and more injurious methods of securing money.

Loans may be used to supply the fiscal demands arising from public works.

It remains yet to consider another plea for the employment of public credit. The necessity of loans arises, in the third place, from a determination on the part of the government to enter upon some great work of public improvement. One may say that this plea has no interest for the people of the United States, because neither the Federal Government

nor the governments of the various States are in the habit of undertaking enterprises of such magnitude that loans are found desirable. It is true that the policy with which the people of this country are familiar differs somewhat from that followed by continental governments. In France and Germany it is regarded as part of the proper functions of government to provide those public improvements in which all subjects are alike interested. Still, it is a superficial view of prevalent tendencies to conclude that this question is of no importance to American readers. For, in the first place, the query is sure to arise, sooner or later, if the States were justified in abandoning to private corporations that direct control over internal commerce which they once possessed. The advisability of constitutional limitations which exclude the States as sovereign corporations from the administration of internal improvements is by no means a settled question. But, in the second place, the defense which is here urged for public borrowing is of paramount importance when one turns his attention to local financing. The crowding of our cities brings ever more prominently into view the necessity of adequate provision for sanitary regulations, for education, for street transportation, and the like. It is not safe to leave these matters in the hands of private corporations, and, so far as the local authorities are obliged to take them up, the functions of the local treasury must be extended. People are coming to admit, for example, that private gas companies are a fraud; that their corrupt management exceeds the corruption of city officials. They are coming to see that a corporation which enjoys a monopoly in the supply of any necessary of life, and places its charges above the cost of rendering the service, is guilty of a breach of public trust. Now, it is but a step from the recognition of this fact to the conclusion that the public interest demands an extension rather than a curtailment of municipal functions, and that the problems presented by dense populations are to be solved by attending to the science of government, rather than by denying to municipal authorities a right to perform those

functions which common interest demands. This means that cities may properly consider the advisability of entering upon schemes of internal improvement. One may not, therefore, say that this argument in favor of deficit financing has no pertinency for American readers.

Suppose a government, of any grade whatever, becomes convinced that an extensive system of public improvements is a necessity, does it thereby decide in favor of creating a public debt? This question can not be answered until we have learned what other methods of securing the required capital are open to the administration. The real point of inquiry is this: Whether the enterprises determined upon can be as economically carried through by any other means as by the placement of improvement bonds.

The necessity of a debt might be obviated were it possible to proceed slowly with the work, expending as much each year as the ordinary revenue allows, and, that amount being exhausted, to stop all work until additional funds accumulate. There, indeed, are some sorts of improvements to which this method of procedure would not be detrimental, but no engineer could for a moment defend it as a general rule. Most undertakings will not bear delay without damage to that part of the work already done. Thus, a house half built, and left to stand the exposure of a hard winter, will require a month's work in the spring to repair weather damages. The same is true, only in a more marked degree, of dock-building, dredging, the making of levees, canals, or railroads. Indeed, there are few exceptions to the statement that continued application of new capital is needed to save the capital already applied; from which it follows that small annual appropriations, for the purpose of carrying through a great undertaking, come under the severe condemnation of engineering rules. It is essential that sufficient control over capital should be secured at the beginning to insure the completion of the work without interruption.

Again, the government might levy and collect an extraordinary tax, equal to the estimated cost of the entire enter-

prise ; this would satisfy the demand of the engineer, and at the same time obviate the necessity of an appeal to public credit. The chief objection to this plan lies in the fact that it disregards certain well-established principles of taxation. It contravenes the fundamental rule of finance that a revenue system should be stable. Taxes are a most important element in what may be termed the industrial environment, and for that reason should not be subjected to sudden and arbitrary changes. Such changes introduce unnecessary disturbances into business relations, and prove a benefit to speculators only, whose gains are always dishonest. It makes no difference whether rates go up or down, in either case the modification of usual relations introduces unreliable factors into business calculations. For this reason a loan which may be repaid during a series of years is much more economical than a single tax to the entire amount demanded. The justification of a loan, also, under the conditions assumed, is the same for a state as for an individual. It is more convenient to pay by installments than to make headway against large expenditures by a single tax ; for a great expenditure met within the year entails upon the community not only the burden of the payment, but the unnecessary burden of disturbance and inconvenience. The same principle that leads men of ordinary means to approve of loan and building associations, commends the borrowing system to the best interests of an industrial community.

It may be further remarked that the avoidance of a loan by means of the levy of an excessive tax is apparent rather than real, for, with the exception of a small amount that may be met by saving in personal expenditures, this tax must in the first instance be paid out of employed capital. But employed capital can not be reduced without decreasing the output, and in consequence the ultimate result will be that each industrial manager will borrow again sufficient capital to cover the deficit occasioned by the payment of his tax. In tracing out the consequences of this measure, it must not be overlooked that the general demand in the commu-

nity for ordinary goods is not decreased in any marked degree by the action of the government; hence industries must keep up to their normal degree of intensity. It thus appears that this excessive and unusual tax has caused the creation of a debt in the community equal to part if not all of the sum collected by the state. This method, therefore, of avoiding the incumbrance of obligations, resting ultimately upon the industries of the country, does not accomplish that which is claimed for it. In the case of a public loan, there is a single debtor—the government—and a thousand creditors who were previously owners of free capital; in the case of a tax, there are a thousand debtors—those who paid the tax out of their employed capital—and the same creditors as before. It thus appears that the financial question involved pertains to the form of a debt which must in any instance be created, and reduces itself to this: Can the administration procure capital upon easier terms than a private corporation? Now it is well known that, in the absence of any unusual and peculiar influences, the credit of a state stands higher than the credit of private corporations within the state. There are many instances in which this relation is reversed, but the statement is a general truth; and, if all governing bodies would be honest in their dealings and follow strict rules of finance, it would become a universal truth. We are then forced to concede that the capital necessary to carry on any great public work may be more economically procured through loans than by means of a single tax.

The foregoing discussion leads us to recognize that public credit may be advantageously employed to cover running deficits, to assist in meeting sudden and unforeseen emergencies, and to provide revenue for carrying on public improvements. It has, however, made no distinction between the sovereign and the corporate duties imposed upon governments, nor has it attempted to classify debts according to the nature of the service for which they are created. Such a distinction is necessary for further analysis, because a gov-

ernment always finds that its rules for administration are shaped by the duties it is called upon to perform. When, for example, the subjects of a state must be protected from foreign invasion, the government exercises functions essentially sovereign, and the principles to which all its decisions should conform are of a sovereign character. The Department of Treasury, like the Department of War, feels the imperative character of the situation, and freely adopts methods of coercion which, under ordinary circumstances, could not be defended. It follows from this that the rules for the administration of a war-debt are shaped, in a large degree, by the attitude of sovereignty which the financier is obliged to assume.

On the other hand, a debt contracted for some industrial purpose does not so manifestly rest upon the exercise of sovereign power. In this case the activity of the state is more nearly akin to that of a private corporation, and the rules to which it should conform are in some degree rules of corporate management. It is true that public bonds always rest on the power to tax, and that this power is essentially a sovereign power, so that, whether a debt be contracted for the purpose of war or for public improvements, it must be the act of a body exercising sovereign powers. It is also admitted that there are difficulties in maintaining this distinction. But, notwithstanding these concessions, it is yet believed that a failure to notice the various purposes for which debts are created, and the modification in the rules of management thus imposed, is responsible for much of that confusion observed in the administration of public treasuries. It is for this reason that I have thought best to accept the distinction here suggested as the basis of classification for further study. In the chapters that immediately follow, making up Part II of this essay, will be undertaken a discussion of those technical questions that arise in connection with National Deficit Financiering, the expression being used in the American rather than in the European sense. In contrast with this, Part III will be devoted to a consideration of the exercise of

the power to make loans for corporate rather than sovereign purposes, and will embrace a discussion of Local Deficit Financing. This part will include a study of the management of public debts by the States and by the minor civil divisions.

PART II.

NATIONAL DEFICIT FINANCIERING.

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NATIONAL DEFICIT FINANCIERING.

CHAPTER I.

FINANCIAL MANAGEMENT OF A WAR.

THE prosecution of a war of such magnitude as to call for large expenditure of money, imposes upon the minister of finance the duty of adopting a policy for the management of the public treasury. Under modern industrial conditions, however, his choice is quite restricted, for there are but three proposals which it is worth his while to consider. These proposals are as follows:

1. The entire war expenditure may be drawn from newly-levied taxes. In the administration of this policy the only loans required are loans in anticipation of tax receipts, in order to cover the demands upon the treasury during the period in which the new revenue system is becoming operative.
2. The entire expenditure of the war may be met from the proceeds of loans. In this case there is a call for new taxes equal to the interest upon the loans contracted. Sometimes even interest payments are met by selling new bonds, but this is so manifestly at variance with sound rules of finance that it need not be considered.
3. The extraordinary expenditure entailed by the war may come from a reasonable union of these two sources of revenue—loans and taxes. The important question pre-

sented by this policy pertains, of course, to the nature of the union proposed, and to the ratio of proceeds by loans to proceeds from taxes; and it is further necessary to inquire if this ratio is the same for all stages of the war.

It must be remembered throughout the investigation, in this manner laid before us, that our problem has primarily to do with extraordinary expenditure—that is to say, with expenditure over and above the demands of peace. Nor does this properly present the extent of the treasury problem. It is more than likely that some of the ordinary sources of revenue will be cut off by a state of war, so that new ways of securing money must be opened to cover the deficits in permanent demands. An adequate financial policy, therefore, must be more than sufficient to make headway against war expenditures.

Shall the entire extraordinary expenditure entailed by a war be met by an exercise of the taxing power?

This question brings us at once into the presence of a claim respecting which there is great diversity of opinion. There are those who assume, without proof or argument, that a people engaged in an exhaustive conflict are unable to bear any marked increase in taxation so long as the conflict shall continue. There are others who, stopping short of this extreme claim, yet urge it as highly desirable that the burden of a war should be distributed over several generations. From such premises the adoption of the loan policy must logically follow. As opposed to such opinions, there are writers of respectability and standing in finance who deny the inability of a people to meet within the year all necessary expenditures, and who refuse assent to the time-honored argument that by a loan the burden of a war may be distributed. Such writers claim that the generation engaged in the contest must bear the burden of its expense; that this burden can in no manner be bequeathed; but that, if the war entail a debt upon the following generations, its burden is born twice—once by the fathers who furnished the capital that was destroyed, and once by the sons who finished the

money to expunge the debt. Although this latter conception of war expenditure does not appear to me to be quite accurate, it is yet based upon the manifest truth that each generation must subsist upon the product of its own industry. No father can eat the potatoes to be hoed by an unborn son, nor can an army live on bread to be delivered, at the option of the baker, between ten and forty years from the date of the contract. It is thus the production of the past and the present, and not that of the present and the future, which furnishes the required capital for a war.

Such a statement of truisms, however, is no final argument in favor of the taxing policy, nor does it meet fairly the claim of those who say that by means of loans the burden of a conflict may in part be thrown upon posterity. They who claim that war expenditure should be entirely met from the proceeds of taxes fail to recognize two very important facts. In the first place, they fail to understand the difference between capital expended in a war and the burden entailed upon the citizens of a country by a war. The consumption of capital may or may not give rise to the consciousness of extraordinary expenditure on the part of the state, according as it does or does not effect involuntary privation. The real burden of a war consists in the fact that men are deprived of property without the compensation of hope. In the second place—and here lies the kernel of the argument—they fail to perceive that the most important factor for the financier is not the material but the psychological factor. It stands as a first principle in an adequate war policy that, however great may be the demand for a current year, it should be met in such a manner that the source from which supply is drawn may never be exhausted. The appeal of the financier to the industrial producers should be made in such alluring language that, while continually giving of their product to the state, their energy will never be slackened. The fund of current product, from which all revenue is drawn, should be as unfailing as the widow's cruse of oil.

It may appear at first glance that the realization of this

principle in actual treasury management is impossible ; but it is perfectly feasible, provided only a proper financial policy be adopted. It is an error to suppose that current consumption in time of war is largely increased over average consumption in time of peace. Public consumption may be greater, but private expenditure is curtailed. Unless mercenaries are brought from abroad, no more of the necessaries of life are required than before the mobilization of the army, and on the average such as are consumed will be of no better quality. To balance the increase of capital required for the manufacture of arms, powder, ships, and the like, there is a decrease in the rapidity with which capital is invested in forms adapted to peace employments. It is, however, necessary to notice that average production can only be maintained by unusual exertion on the part of non-belligerents, for the ranks of peace workers will have been depleted by enlistments in the army. This call for increased activity is, in reality, the first tax sustained by those who continue to follow the common pursuits of life. But this tax need not be the occasion of solicitude, for common habit may be relied upon to tide over this first draft of men from the industrial ranks. A farmer who, with three sons, has been accustomed to cultivate a section of land, will not permit a hundred and sixty acres to lie fallow because one of his sons has joined the army. It is a truth of quite general application that men are disinclined to fall below a standard once achieved ; and it is upon the principle of human nature which this truth discloses that the financier may rely for the maintenance of average production, notwithstanding the reduction in laboring force.

The real question that confronts the financier is the following : Can he expect this increased activity will be maintained if, in addition to the labor-tax, he levy a money-tax equal to the entire expense of supporting the army ? To answer this question in the negative is not to deny whatever is true in the claim that taxes tend to quicken production. A tax levied for that purpose must gradually and persistently,

and through a long series of years, raise the rate which it imposes; the desired result would not follow should industries be subjected without warning to excessive charges. For example, is it reasonable to believe that the industry of the Northern States would have been rendered more intense if the total expenditure of 1862 had been met by taxation? The expenditure of that year was equal to one quarter of the total national product, while the extraordinary war expenditure was equal to one fifth of such product. Assuming that newly levied taxes might have secured the money for 1862, can one suppose that the year 1865, when war expenditure amounted to twenty-seven per cent of gross product, would have furnished an adequate amount of disposable capital? No one who understands the psychology of taxation can for a moment admit such a claim. A tax so excessive in amount, precipitated without warning upon established industries, would have encroached upon working profit, weakened the incentive to labor, broken the mainspring of activity, and destroyed the mechanism of production. It would, therefore, have disregarded the first principle of treasury management, for it would have dried up the source from which all revenue must come. An adequate policy for the conduct of a war must be able to carry a people through to the end, and not expose them to the danger of a stranded treasury in the midst of conflict.

If, on the other hand, a part of the extraordinary expenditure should be met by an appeal to credit, the loans would be largely absorbed by free capital. This would cause no derangement of existing industries, and the saving in this manner secured would be voluntary saving. The idea of loss would not attend the payment of capital to the state, but rather the thought of establishing a permanent income would induce to renewed activity. The administration, therefore, would run no risk of exhausting the fund from which future revenue might be secured, for it would be continuously replenished by willing hands. It is altogether by the mark to say that loans must in the end be paid from the proceeds of

taxes, and that, in consequence, the advantage of an appeal to credit is apparent rather than real. The question is, whether the desire to avoid taxes in the future will induce men to suffer the burden of present payments. If they truthfully declare such willingness, there can be no necessity of resorting to credit. But if, as an analysis of character declares, the potency of motives is inversely as the remoteness of interests concerned, this abstract truth, that taxes must finally equal the sums borrowed, can not be relied upon to induce men to practice self-restraint in consumption, or to undergo severe toil in production. It is such considerations as these that lead us to regard the taxing policy as inadequate to the demand of an exhaustive war.

Shall the extraordinary expenditure imposed by a war be covered entirely by the proceeds of loans?

The policy which is here brought to view has been a favorite one with many financiers. The general claim in its favor is that, while a people are engaged in war, their industries should be freed from all unnecessary incumbrances, in order that they may supply the "extra product" which the "extra consumption of the government" demands. The conclusion of such reasoning is that, while a war lasts, no new taxes should be imposed.

It has been already observed, in the foregoing discussion, that the conception here presented is erroneous. The consumption of a people engaged in war is not greatly in excess of peace consumption. It may, if necessary, be brought down to less than peace consumption. An adequate financial policy demands only that average production should be maintained. It is true that average production calls for more intense application on the part of non-belligerents, but, if business men are not discouraged by an erroneous financial policy, the industrial habits of the people may be relied upon to attain this end. Indeed, the administration may reasonably hope that a certain amount of taxes will be willingly paid, in addition to what was termed above the labor-tax. The motive or force which the financier must call into play

to secure so desirable an end is patriotism. If the purpose of the government be fully appreciated and approved, a free people will gladly undergo extensive sacrifices in order to carry out an adopted policy. It is a recognized fact that self-governing peoples are stronger for tax purposes than the subjects of a monarchical state, for their will lies more closely to the heart of the state. But the administration of a self-governing people should never undertake a war in favor of which there is no strong sentiment. As things go, then, in democratic countries, it does not appear that loans to the full extent of extraordinary demands are necessary, and there is no question as to the superiority of taxes over loans when their use will not curtail industrial energy. The measure of this first money-tax should be the popular enthusiasm for the war.

What, however, is the specific argument against the policy of securing the entire war revenue from loans? Many considerations might be presented showing the dangers that beset this method of financing, but a study of certain attempted realizations of it may, perhaps, disclose its inadequacy the most clearly. There are very few cases in which a struggle of any magnitude, testing at all a people's financial resources, has been carried to a successful issue on the basis of a loan policy; while there are many instances of an abandonment of this policy during the progress of a war, which itself must be accepted as confession of failure. Twice in the history of our own country has this fatal overconfidence in the sufficiency of public credit brought a rich and energetic people to feel the stress of money demands, and to experience the evils of ruinous and expensive methods of treasury control. It is not true that the actual failure of any policy proves the impossibility of its success; but it is true that a careful study of several failures will permit one to decide whether continued ill-success is due to inadequate management or to erroneous principles in the policy itself. Understanding, then, the limitations rightfully placed upon all arguments from history, let us turn our attention to the

financial conduct of the two great wars in which the United States has been engaged—that of 1812 and that of 1861.

The financial policy which was adopted for the conduct of the war of 1812 finds its first statement in the treasury report of 1807. This has been called the war-report of Albert Gallatin. The reason why so astute a politician forced this question thus early upon the attention of Congress may not, perhaps, with clearness be determined; it is sufficient for our present purpose to notice the fact. The financial condition of the treasury at this time was as follows: The permanent revenue of the country was estimated at \$14,500,000, while the permanent expenditure for peace purposes was estimated at \$11,600,000. In this expenditure, however, there was included an annual payment on account of the debt-service of \$8,000,000, which would be reduced to \$3,400,000 after 1808, because of the inability of the government to proceed as rapidly as heretofore in the expungement of the debt. Taking this into the account, the permanent expenditures on a peace basis could not exceed \$7,000,000, and this would provide a permanent annual surplus of \$7,500,000.

It was in the presence of such financial prospects that the Secretary spoke his views on the proper method of treasury administration in the event of a commercial war. His plan may be the best presented in his own words, which are as follows:

That the revenue of the United States will, in subsequent years, be considerably impaired by a war, neither can or ought to be concealed. It is, on the contrary, necessary, in order to prepare for the crisis, to take an early view of the subject, and to examine the resources which should be selected for supplying the deficiency and defraying the extraordinary expenses.

There are no data from which the extent of the defalcation can at this moment be calculated, or even estimated. It will be sufficient to state—1. That it appears necessary to provide a revenue at least equal to the annual expenses on a peace establishment, the interest of the existing debt, and the interest on the loans which may be raised. 2. That those expenses, together with the interest of the debt, will, after the year 1808,

amount to a sum less than \$7,900,000 ; and, therefore, if the present revenue of \$14,500,000 shall not be diminished more than one half by a war, it will still be adequate to that object, leaving only the interest of war-loans to be provided for.

Whether taxes should be raised to a greater amount, or loans be altogether relied on for defraying the expenses of the war, is the next subject of consideration.

Taxes are paid by the great mass of the citizens, and immediately affect almost every individual in the community. Loans are supplied by capitals previously supplied by a few individuals. In a country where the resources of the individuals are not generally and materially affected by the war, it is practicable and wise to raise by taxes the greater part, at least, of the annual supplies. The credit of a nation may also, from various circumstances, be at times so far impaired as to leave no resource but taxation. In both respects the situation of the United States is totally dissimilar.

There is no question but that the Secretary here expresses full confidence in the adequacy of the loan policy to meet the financial stress of a war. It is true that he suggests the levy of certain new taxes, but their purpose is "to provide for the interest of war-loans, and to cover deficiencies in case the existing revenue should fall below seven millions of dollars." He does not contemplate taxation as a means of defraying war expenditure.

A clearer statement of this policy is to be found in the report of 1808 :

No internal taxes [says the Secretary], either direct or indirect, are therefore contemplated, even in the case of hostilities carried against the two great belligerent powers.

And the report of 1809 comes back again to the same thought :

Loans reimbursable by installments, at fixed periods, after the return of peace, must constitute the principal resources for defraying the extraordinary expenses of the war.

So far, then, there can be no question as to Mr. Gallatin's views respecting the financial conduct of a war; but the impression has somehow arisen that the events of the years 1810 and 1811 caused him to modify the opinions

which he had previously expressed, and to urge upon Congress the adoption of taxes to a degree wholly at variance with his original plan.¹ There is, however, no evidence which warrants one in the belief that the Secretary had abandoned the theory of loan financing; but, on the other hand, in a letter of January, 10, 1812, addressed to the chairman of the Committee of Ways and Means, there may be found a restatement of the loan policy, perfect in every essential particular. It is true that the committee was recommended to urge the establishment of both direct and indirect taxes, but this was due to the fact that customs revenue had fallen below the estimates of peace demands. These taxes, therefore, could not with propriety be termed "war-taxes," since their proceeds were to be devoted to cover peace expenditure.

It may be proper to repeat [wrote Mr. Gallatin] that so long as the public credit is preserved and a sufficient revenue is provided, no doubts are entertained of the possibility of procuring, on loan, the sums wanted to defray the extraordinary expenses of a war, and that the apprehensions expressed relate solely to the terms of the loans, to the rate of interest at which they can be obtained.²

Again, in another place, he says: "In proportion as the ability to borrow is diminished, the necessity of resorting to taxation is increased." Such a sentence as this could not have been written except by one who had turned his back squarely upon the policy of war taxation. It regards taxes as a last resort, to be employed only when the public credit shall have been exhausted; the tax policy, on the other hand, holds loans in reserve to be used only in presence of the greatest stress.

But did the views of Congress coincide with those of the Secretary? In one particular only do we find them at variance. Mr. Gallatin desired the new loans to rest upon a permanent revenue sufficient to pay current interest, but the

¹ Cf. Adams's "Life of Gallatin," pp. 450-455.

² "Writings of Gallatin," vol. i, p. 514.

members of Congress had no such view of this necessity as to lead them to press to legalization the necessary bills. It was decided by the Committee of Ways and Means that a war of four years' duration could be carried on for \$50,000,000, and in February, 1812, a loan of \$11,000,000 was authorized as the sum needed for the first year. Upon the same day that the House passed the loan bill, Mr. Bacon, chairman of the Committee of Ways and Means, made a report in which he advocated "war-taxes," setting forth in a clear manner the policy of the administration. This committee was as yet under the control of Mr. Gallatin. The speech which attended this report is peculiar, showing as it does the excessive and absurd confidence which the extreme war party had in war-loans. After stating that a loan of \$11,000,000 was regarded as sufficient for the first year, he said :

It is assumed by the committee that extraordinary or war expenditure of the two succeeding years shall also rest upon further loans ; and it is supposed that revenue sufficient to pay only the ordinary expenses and the interest on the old debt and on new loans shall be immediately provided for by the government.¹

That which is peculiar in Mr. Bacon's speech is his warning to Congress against relying upon the proceeds of loans to pay the interest upon debts contracted.

If we suffer ourselves [he said] to yield to the new theory of borrowing both principal and interest, we have no data by which to judge upon what probable terms loans may be obtained at all, or how long it will be before we must wind up business.²

Still the temper of the House called for just such arguments, for there was a strong faction that held taxes for the payment of current interest to be superfluous. "How are the exigencies of the government for the next year to be supplied ?" exclaimed Mr. Cheeves, who was spokesman for this faction. "Is the deficiency to be derived from taxes ?

¹ "Annals of Congress," for Twelfth Congress, 1st Session, col. 1095.

² "Annals of Congress," for Twelfth Congress, 1st Session, col. 1098.

No, I will tell gentlemen who are opposed to them, for their comfort, that there will be no taxes imposed for the next year." And yet in the expenditures for the next year it was necessary to include the interest upon loans already voted. There can be no question but that the financial policy adopted at the beginning of the war of 1812 looked to credit, rather than taxes, as the source of all extraordinary expenditure.¹ Let us then inquire respecting the results of this endeavor to realize the loan policy.

It is not my purpose to trace in detail the course of financial management of the war of 1812. All that is essential to the end held in view may be succinctly presented by a few comments upon the two tables that follow. In these tables will be found certain facts pertaining to the employment of public credit, whether in the form of direct loans or of an issue of treasury notes ; the amounts authorized by the several acts, the amounts issued, and the conditions of their sale, will show quite clearly the degree of success that attended the administration of the loan policy. It is necessary to observe that war was declared upon June 18, 1812, and that the news of a definite treaty of peace arrived in New York upon February 13, 1815. The period covered by the tables, therefore, pertains to those financial measures considered by Congress in view of a continuance of the war, as well as to the employment of public credit for war purposes.

¹ It is indeed amusing to notice the spleen with which the extreme war party opposed even the moderate proposals of Mr. Bacon for taxation. "At the last session," exclaimed Mr. Wright, of Maryland, "when the question for rechartering the odious British bank was before us, we had to encounter the influence of the Secretary of the Treasury. . . . Now, at this session, he has told us that, if we had a national bank, we should have no occasion to resort to internal taxes ; thereby calling the American people to review the conduct of their representatives in not continuing that bank, and thereby to fix the odium of these odious taxes on the National Legislature. Now a system of taxes is presented truly odious, in my opinion, to the people, to disgust them with their representatives and to chill the war spirit. . . . Sir, is there anything of originality in his [Mr. Gallatin's] system ? No ! it is treading in the muddy footsteps of his official predecessors, in attempting to strap around the necks of the people this odious system of taxation," etc.

TABLE A.—*Showing loans authorized, and the facts concerning their sale, for the war of 1812.*

Date of loans authorized.	Amounts authorized.	Amounts issued.	Rate of interest.	Rate of sale.	Rate of sale estimated on gold basis.
March 14, 1812.....	\$11,000,000	\$10,284,700.00	6 $\frac{1}{2}$	par.	par.
February 8, 1813....	18,000,000	18,109,377.43	6 $\frac{1}{2}$	88	88
August 2, 1813.....	7,500,000	8,498,581.95	6 $\frac{1}{2}$	88 $\frac{1}{2}$	88 $\frac{1}{2}$
		{ 9,919,476.35	6 $\frac{1}{2}$	80	80
March 24, 1814.....	25,000,000	{ 5,884,188.87	6 $\frac{1}{2}$	80	70
		{ 746,403.81	6 $\frac{1}{2}$	80-95	65-69
November 15, 1814..	8,000,000	{ 1,450,000.00	6 $\frac{1}{2}$, 7 $\frac{1}{2}$	par.	81-89
January 9, 1815....	6,000,000	200,000.00	6 $\frac{1}{2}$	par.	89

TABLE B.—*Showing treasury notes authorized, and the facts concerning their sale, for the war of 1812.*

Date of acts authorizing Treasury notes.	Amounts authorized.	Amounts issued.	Rate of interest.	Rate of sale.	Rate of sale estimated on gold basis.
June 30, 1812.....	\$5,000,000	\$5,000,000	5 $\frac{1}{2}$ %	par.	par.
February 25, 1813...	5,000,000	5,000,000	5 $\frac{1}{2}$ %	par.	par.
March 4, 1814.....	10,000,000	10,000,000	5 $\frac{1}{2}$ %	par.	84-91
December 26, 1814..	10,500,000	8,818,400	5 $\frac{1}{2}$ %	par.	86-90
February 24, 1815...	25,000,000	17,482,780	6 $\frac{1}{2}$, 7 $\frac{1}{2}$	100-104	82-90

One of the most significant facts which a comparison of these two tables presents, is the relation that seems to exist between loans and treasury notes. As the power of Congress to secure money by the sale of bonds decreased, reliance upon treasury notes increased. The inability of the government to place bonds was recognized in the latter part of 1814: in December of that year and February the year following, \$35,500,000 of treasury notes were authorized. Turning now to a consideration of the loans proper, the record of events shows that the first loan met with no enthusiasm. Although \$11,000,000 had been authorized, and the Secretary was anxious that subscriptions should be rapid and

¹ No stock was actually issued, but this sum was borrowed from the banks.

sufficient to absorb the entire sum, he found at the end of two months that only \$6,000,000 of the stock had been subscribed. Mr. Gallatin admitted that the success of the loan was "more than doubtful," and it was because of the tardy sale of bonds that Congress authorized the first issue of treasury notes. It is true that the terms of this first loan were not attractive, and that the greatest enthusiasm for the war was found outside the moneyed classes; but one must not lose sight of the fact that the only new taxes levied for the support of this loan consisted in a slight alteration of tonnage rates and a tardy increase of customs duties. The financial policy upon which this war was to be carried through appears to have shown signs of weakness before the struggle had been fairly begun.

On February 8th, the following year, the government again came upon the market for money, this time demanding \$16,000,000. The weakness of the previous loan was charged to the fact that too strict conditions had been imposed upon the administration in its negotiations; in this loan, therefore, as in all subsequent loans, the only condition insisted on by Congress was the right of reimbursement after a specified term of years. The passage of this act elicited much discussion, concerning both the propriety of the war and the adequacy of the financial policy. Some few members saw that loans resting on good intentions only must lead to disaster.

In finance [said one member] the wisdom of man has never been able to discover any effectual security to public credit short of certain funds or revenue pledged for the redemption, and sufficiently productive to pay at least the interest, of the debt.¹

Oddly enough, Stewart on "Political Economy" was quoted in support of this common-sense remark. But common sense does not seem to have been regarded at this time as essential to the guidance of the nation's finances, and no

¹ "Annals of Congress," for Twelfth Congress, 2d session, col. 896.

steps were taken toward an increase of taxation. This loan was placed at eighty-eight cents on the dollar, while pressing demands were met by an additional issue of \$5,000,000 in treasury notes.

Still there are many expressions which show that Congress was beginning to suspect the inadequacy of the loan policy, and at an extra session, called in May, 1813, steps were taken toward laying the foundation of a system of internal revenue. But it would be an error to suppose that the original loan policy was at this time abandoned. Congress had now reached the position defined in Gallatin's financial reports, and recognized the necessity of providing some basis for the credit of the state. There is but the slightest suggestion in the report of Mr. Jones, who was then acting as Secretary of the Treasury, which looked to the employment of taxes for making headway against war demands. According to his view, the chief benefit of new taxes would accrue in enabling the government to carry out its loan policy.

As reliance [he says] must be had upon a loan, for the war expenses of the year 1814, the laying of the internal taxes may be considered, with a view to that object, as essentially necessary : in the first place, to facilitate the obtaining of the loan ; and secondly, for procuring it on favorable terms.

From the message of the President, also, may one learn that the difficulty of negotiating bonds at par was regarded as the only justification of new taxes. The revenue system, as adopted, included a direct tax upon the several States, and internal duties of various sorts. They were called "war-taxes," and, by the act that authorized them, were limited to one year from the conclusion of a treaty of peace. The adoption of this system, however, appears to have had little influence upon public credit, partly because the new source of revenue could not be relied upon for at least a year, but more especially because the new taxes were temporary, and not co-existent with the debts assigned to them.

This plan of carrying on the war by the proceeds of loans

may be said to have broken down in connection with the \$25,000,000 loan of 1814. To measure adequately the magnitude of this operation, it must be taken in connection with the \$10,000,000 of treasury notes authorized about the same time, from which it appears that \$35,000,000 of debt were created by Congress to cover the appropriations of a single sitting. This was a sum equal to five times the average peace expenditure, and to the total *ante bellum* revenue for two and a half years; and it was thought that this sum might safely rest upon the modest appeal to tax contributions just mentioned.

There is one element of complication that must not be overlooked, if the danger and uncertainty which attended the financial operations of this period are to be clearly perceived. Mr. Gallatin had relied largely for the success of his plan, as presented in 1807, upon the assistance of the United States Bank. He thought to control the circulating medium of the country by means of this institution, and to procure from it much assistance in the placement of public bonds. Nor can it be doubted that Congress, in refusing to grant a renewal of the charter of the bank, is largely responsible for the financial straits into which the government fell. The increase in the circulation of the private banks brought with it the evils of inflation, even before the suspension of specie payments, which occurred in August and September, 1814. Some conception of the difficulty of carrying through any financial operation may be gained when one learns that the government was obliged to select ninety-four State banks as the depositories of its funds; and, so various were the kinds of paper money in use, that it was found necessary to keep four separate ledger accounts in each. This can not, however, be urged as an adequate excuse for the failure of that financial policy adopted for the prosecution of the war. All that may be truthfully said is, that the failure of this policy was demonstrated more quickly than would have been the case could specie payments and clear accounts have been maintained.

From the table given above, it appears that the proceeds of the loan of March 24, 1814, are presented in three separate sets of figures. This method is adopted in order that the tendencies making their appearance at this time in connection with treasury management may be more perfectly disclosed. There was authorized by this act a placement of \$25,000,000 of bonds. The first call was for \$10,000,000, which resulted in the receipt of \$7,935,581 in cash, and in the issue of \$9,919,476 in six-per-cent stock. This, it will be observed, was a sale of bonds at twenty per cent discount, being a lower price by eight cents in the dollar than any which the government had previously accepted. Four months later, a second advertisement appeared calling for \$6,000,000 additional of the \$25,000,000 authorized. The amount of debt created by this operation was \$5,384,134, but the equivalent of cash received into the treasury was only \$4,307,307. At the time, however, that the major part of this loan was negotiated, a depreciated paper was accepted as the medium of payment; and, if one permit this discount to modify his calculations, he will discover that the specie price of these bonds was a trifle above seventy cents on the dollar. Nor do these figures adequately present the decadence of public credit, for the government found it necessary to resort to unusual devices in order to place the bonds at all. To the extent of \$1,900,000 this debt found subscribers in the cities of New York, Philadelphia, and Baltimore, on condition that the amounts subscribed should be expended in the defense of the cities furnishing the money. Such dickering and trading show the exhausted condition of public credit even more clearly than the discount suffered.

The third attempt to raise money on authority of the act of March 24th marks the collapse of the loan policy. Of the total amount of debt authorized, there remained \$12,757,112 to be placed, and we may be sure that the government would have gladly received the entire sum. The amount of stock created was \$746,403, the equivalent of cash received being \$652,534. The nominal price varied from eighty to ninety-

five, the specie price ranging from sixty-five to sixty-nine. Of the moneys thus received, less than \$234,000 were available for war purposes, the remainder being paid after the declaration of peace; and of this modest sum \$150,000 was signed by certain corporations of Baltimore to build a frigate for the defense of their own harbor. During the last quarter of the year 1814, receipts from all sources fell far short of expenditures, so that an actual deficit of \$3,800,000 made its appearance in public accounts.

Do not such facts justify the conclusion that the control of the public treasury during the war of 1812 proved a failure? At the beginning of the struggle, Mr. Bacon said he did not know how long it would be before the treasury must "wind up business"; the course of events showed that it was possible to run on baseless promises a little over two years. But it may be asked: Was this failure due to the erroneous principles upon which the financial policy was based, or to bad administration? The testimony of contemporary statesmen upon this point is of much importance. In the latter part of 1814, the necessity for new and vigorous revenue legislation came to be quite generally recognized. The President stated this as one of the two reasons for calling an extra session of Congress in September. But the most direct and complete testimony upon this point is found in the financial documents of Mr. Dallas, who was called to administer the Department of the Treasury. "The plan of finance," says the new Secretary, referring to the months in question, "which was predicated upon the theory of defraying the extraordinary expenses of the war by successive loans, had already become inoperative." Nor did the new Secretary shrink from placing the responsibility of failure where it belonged. The falling off of revenue and the collapse of credit were not ascribed by him to either "the want of resources or the want of integrity in the nation," but "to the inadequacy of our system of taxation to form a foundation of public credit, and the absence from our system of the means which are the best adapted to anticipate, collect, and distribute the

public revenue." He proposed the adoption of a new plan of finance, the characterizing feature of which should be "prompt and resolute application to the resources of the country." In addition to the re-establishment of a national bank, his policy embraced three distinct revenue measures. He demanded, first, war-taxes, nor did he mean by this expression what Mr. Bacon meant in 1812; second, tax-loans, or temporary loans, by means of which the new taxes could become immediately available; third, an extensive use of treasury notes, approaching a little more nearly our modern idea of legal tenders.¹

Any criticism upon this plan should be made in view of the fact that two years of inadequate financial administration had bequeathed a legacy of confusion and of disordered credit. The problem presented to Mr. Dallas did not consist in forming a war policy which should harmonize in all particulars with the requirements of sound finance, but in rescuing the finances of the state from disaster already experienced. So far as his plan refers to taxes, it is commendable. Twenty-one millions were to be drawn from this source. The tax-loans, also, were demanded by the necessities of the case. It is likewise commendable that he did not at this time make the treasury notes a legal tender for the payment of debts. Yet this would have been the necessary and logical result of the financial policy framed by Gallatin. They who defend the loan policy always assume that public credit can be maintained by an increase of the tax-levy equal to the current demands of the public stock created, but this is found to be a mistake. It is because this is impossible, and because men will not freely lend, that the government feels justified in forcing a loan out of the people by means of legal-tender notes. The first issue of treasury notes, it will

¹ This financial plan, submitted by Secretary Dallas, may be found in a letter of October 17, 1814, addressed to the Committee of Ways and Means. The note from the committee, asking for suggestions, is also significant. Its first sentence is as follows: "The Committee of Ways and Means have had under their consideration the support of public credit by a system of taxation more extended than the one hitherto adopted." Cf. "Life and Writings of Dallas," pp. 234-243.

be remembered, was regarded as necessary because of the tardy sale of bonds, and it is but another step in the path already entered upon to give notes a forced circulation. Legal-tender notes lie as a germ in the loan policy, and it is probable that the termination of the war saved the country from the calamity which their issue would have occasioned.

Some of my readers may be inclined to excuse Mr. Gallatin from all responsibility, and to deny that the failure of treasury administration during the war of 1812 argues aught against the sufficiency of the loan policy proposed by him, because Congress refused to grant the new taxes asked for at the beginning of the war. It is true that a proper administration of the loan policy demands clear revenue equal to the debt service and the peace expenditure. It is also true that the special tax-bills recommended to the Twelfth Congress failed to secure legal sanction ; but it would be incorrect to conclude, because these particular taxes were withheld, that the essential requirements of the loan policy were not complied with. A glance at the general balance-sheet covering the three years of the war will show that permanent revenue not only covered permanent expenditure, but furnished a surplus of nearly \$6,000,000 for war purposes. Although the new taxes were refused, the receipts from old taxes exceeded expectation ; it is impossible, therefore, for the advocates of the loan theory to shift the responsibility of the failure of Mr. Gallatin's policy upon the shoulders of Congress. This balance-sheet is presented in the following table :

Table showing the source of moneys expended for war purposes.

YEAR ENDING	War expenditure paid out of proceeds of taxes.	War expenditure paid out of proceeds of loans.
December 31, 1812.....	\$3,560,150.00	\$12,477,988.39
December 31, 1813.....	1,899,277.71	24,849,810.41
December 31, 1814.....	775,828.58	27,047,809.37 ¹
Total.....	\$5,235,256.24	\$64,375,108.17

¹ There is included in this sum an actual deficit in accounts.

It thus appears that, for a total war expenditure of some \$70,000,000, it was found necessary to create a debt of only \$64,300,000, a fact which shows how futile is an apology like that suggested above in favor of the loan policy. So far as clear revenue is concerned, the demands of the theory were met, and it is the theory rather than the remissness of Congress that must be held responsible.

Or, again, it may be that some one, quoting that old maxim, *salus populi suprema lex*, a maxim regarded by dullards as the first principle in finance, will ask: Wherein did this policy fail? Did not the Government get the money and carry through the war? Such a question can only be answered by placing the actual results of treasury management during the war of 1812 in comparison with the demands of adequate management.

An adequate financial policy will place the credit of a state on so firm a basis, and guard it so jealously, that the government will never be called upon to suffer ruinous discount in the placement of its bonds. The record of this war shows that even at the beginning there was no enthusiasm for the public stocks, that every month as it passed saw the nation's credit decline, and that the last quarter of the year 1814 showed a deficit in public accounts while the government still possessed the right to borrow \$12,000,000.

An adequate financial policy will provide such extensive resources that a war once entered upon may be carried through to the end without change of plan. It must be elastic and pliable, so as to be ready for all probable emergencies. In the present instance, after little more than two years of vain endeavor to supply the demands of the government, the original plan was abandoned, and a new theory was admitted by the administration and by Congress. The evils necessarily attendant upon this change in the midst of a war were only obviated by the return of peace.

An adequate financial policy will not be forced to use treasury notes, except as a convenient method of managing its taxing system. We have already noticed how that un-

warranted interference with the circulating medium follows logically from a determination to throw the entire weight of war expenditure upon public credit.

It must be admitted that Mr. Dallas passed lightly over this stupendous failure in financial administration when, in reviewing the financial operations of the war, he said :

An increase of the expense, and a diminution of the supply, must have been anticipated as the inevitable consequences of that event ; but the government reposed with confidence for all the requisite support upon the untried resources of the nation in credit, in capital, and in industry. The confidence was justly reposed ; yet it may, perhaps, be considered as the subject for regret, and it certainly furnishes a lesson of practical policy, that there existed no system by which the internal resources of the country could be brought at once into action, when the resources of its external commerce became incompetent to answer the exigencies of the time. The existence of such a system would probably have invigorated the early movements of the war, might have preserved the public credit unimpaired, and would have rendered the pecuniary contributions of the people more equal as well as more effective. But, owing to the want of such a system, a sudden, and an almost exclusive, resort to the public credit was necessarily adopted as the chief instrument of finance. The nature of the instrument employed was soon developed ; and it was found that public credit could only be durably maintained upon the broad foundations of public revenue.¹

It is not my purpose to follow thus in detail the financial history of the war of 1861. So far as principles are concerned, it presents nothing with which the foregoing study has not already made us familiar. Here is found the same policy for the management of the public treasury ; this policy follows the same course in its development, and works the same general results. The only variation in the record pertains to the use of treasury notes, for, in the case of this second war, the loan policy was not arrested until these notes were given the legal power of paying private debts. Upon the main point there can be no question. The plan recommended by Secretary Chase, and adopted by Congress, was

¹ "Report on the Finances," December, 1815.

to rely upon public credit for carrying through the war. In a special report of July, 1861, which deals with ways and means, the Secretary expresses himself as follows:

To provide the large sums required for ordinary expenditure, and by the existing emergency, it is quite apparent that duties on imports, the chief resource for ordinary disbursements, will not be adequate. The deficiencies of revenue, whether from imports or other sources, must necessarily be supplied from loans; and the problem to be solved is that of so proportioning the former to the latter, and so adjusting the details of both, that the whole amount needed may be obtained with certainty, with due economy, with the least possible inconvenience, and with the greatest possible incidental benefit to the people.

The Secretary has given to this important subject the best consideration which the urgency of varied public duties has allowed, and now submits to the consideration of Congress, with great deference and no little distrust of his own judgment, the conclusions at which he has arrived.

He is of the opinion that not less than eighty millions of dollars should be provided by taxation, and that two hundred and forty millions should be sought through loans.

It will hardly be disputed that, in every sound system of finance, adequate provision by taxation for the prompt discharge of all ordinary demands, for the punctual payment of the interest on loans, and for the creation of a gradually increasing fund for the redemption of the principal, is indispensable. Public credit can only be supported by public faith, and public faith can only be maintained by an economical, energetic, and prudent administration of public affairs, and by the prompt and punctual fulfillment of every public obligation.¹

This financial policy may be more clearly apprehended if we notice the estimates presented by the Secretary. As has been already stated, he proposed to raise \$80,000,000 by taxes, as against \$240,000,000 by loans. Of this amount of clear revenue, \$65,800,000 were required to meet the ordinary expenditures of the peace establishment. It was believed that existing laws would provide about \$60,000,000, from which it followed that new taxes to the amount of \$20,000,000 were required. Of this sum, \$9,000,000 were to be de-

¹ "Report on the Finances," July 4, 1861.

voted to payment of interest upon the new debt, and \$5,000,000 to the establishment of a sinking-fund for its final expungement. Such was the financial plan upon which this great war was begun.

The revenue law which followed this report modified customs duties so as to intensify the principle of industrial protection, established a three-per-cent income-tax upon all incomes over \$800, and apportioned a direct tax of \$20,000,000 among the several States. The income-tax was not to take effect until January, 1862, and, as the direct tax was apportioned to the South as well as to the North, the treasury could not hope for the entire amount levied.

In the December report, 1861, the Secretary declared renewed confidence in the financial plan which he had previously presented. It was found, however, that receipts from customs and from the sale of public lands had fallen off. Thus, for the quarter ending September 30th, customs duties had yielded but \$7,198,602. For the calendar year ending 1861, the government received but \$30,795,795 from this source, as opposed to \$50,747,990 in 1860, and \$53,800,596 in 1859. There seemed, therefore, just ground for apprehension lest existing taxes should fail to support the peace establishment, and the loans which the government chose to place. This fear of a deficit, from ordinary sources of revenue, impressed itself upon the mind of the Secretary, and, in consequence, he proposed additional duties on tea, coffee, and sugar; a modification of the income-tax, so as to render it more productive; an increase of the direct tax to the States; and a tax on whiskies, tobacco, bank-notes, instruments of conveyance, and the like; in short, he proposed the establishment of the system of internal duties. Now, all this has the appearance of an abandonment of the loan-policy, and the adoption of the policy of carrying through the war by taxes, but this is true in appearance only. The total sum of clear revenue hoped for from all these sources of income was but \$90,000,000, and this, as the Secretary said, was not more than enough to meet "even economized disbursements,

and pay the interest on the public debt, and provide a sinking-fund for the gradual reduction of its principal." "It will be seen at a glance," says the report in another place, "that the amount to be derived from taxes forms but a small portion of the sums required for the expenses of the war. For the rest, reliance must be placed on loans." It is also worthy of notice, as throwing additional light upon the policy of the administration, that the mind of the Secretary seems at this time to have been taken up with his scheme for establishing a system of national banking; for, as is well known, one purpose of this scheme was to provide a ready market for public bonds. It comes, therefore, into perfect harmony with the loan policy already adopted.

It was in the latter part of the year 1863, and during the first part of 1864, that the inadequacy of the loan policy as a basis of war-financiering forced itself upon the minds of those who managed public affairs. "To check the increase of debt," says the report of 1863, "must be, in our circumstances, a prominent object of patriotic solicitude." And again: "Hitherto the expenses of the war have been defrayed by loans to an extent which nothing but the expectation of its speedy termination could fully warrant." The report then restated the financial policy as adopted in 1861, and continued:

The financial administration of the first fiscal year after the outbreak of the rebellion was conducted upon these ideas. The acts of Congress at the extra session of July, 1861, were framed with the intention of supplying the full amount of revenue demanded by them. But receipts disappointed expectation, and it soon became obvious that a much larger proportion of the means needed for the fiscal year 1862 than the principle adopted would allow must be derived from loans.

But the most interesting expression in this document pertains to the estimates for probable future demands:

These statements [says the Secretary, referring to the estimates] illustrate the great importance of providing, beyond all contingency, for ordinary expenditures and interest on

debt, and for the largest possible amount of extraordinary expenditures, by taxation. In proportion to the amount raised above the necessary sums for ordinary demands will be the diminution of debt, the diminution of interest, and the improvement of credit. It is hardly too much—perhaps hardly enough—to say that every dollar raised for extraordinary expenditures or reduction of debt is worth two in the increased value of national securities, and increased facilities for the negotiation of indispensable loans.

Could this truth have been recognized at the beginning of the war, and could it at that time have influenced the treasury policy, the financial history of the last twenty-five years would have been materially modified.

Congress also, in the latter part of 1863, began to recognize the essential weakness of the loan policy, and to turn its attention to the necessity of taxes for distinctively war purposes. The great tax-bills of the war were those of June, 1864. Mr. Morrill, in whose speech of a year before there were statements showing that the original policy was yet intact, admitted, while presenting these new bills, that money must now be secured by every possible means :

The treasury [he said] requires a larger supply of means, and such sources of revenue as have not already yielded their maximum contributions must now be sought, so that we may fill the measure of our wants. . . . This [bill] is intended as a war measure, a temporary measure, and it is needful that it pass speedily. Every day's delay in the passage of this and the internal revenue bill costs the treasury not less than \$500,000.¹

This language is very different from the financial diletantism that marked the attitude of our financiers during the first two years of the war.

It is somewhat difficult to exhibit accurately the rapid fall of public credit from 1861 to 1866; but I have undertaken in the following statement to approximate such an exhibit by showing the specie price of all the obligations issued during the war. The computation has been made by estimating the

¹ Young's "Customs-Tariff Legislation," p. cxxxiii.

value of the total receipts from credit for each quarter at the average price of gold during that quarter. The only source of error in this method arises from the fact that the average price of gold for any three months may not be the actual price at which the proceeds of bonds were covered into the treasury, but any closer computation requires more complete data than the authorities at Washington have yet given. It is, however, believed that the conclusions may be relied upon as substantially correct.

Table showing treasury receipts, from public obligations of all sorts, for each quarter during the war, and the gold value of such receipts, estimated on the average price of gold for each quarter.

SUMMARY.	Gross receipts from debt created.	Gold value of gross receipts.	Percentage realized.
For the quarters ending—			
March 31, 1862.....	\$60,947,202.67	\$59,527,132.84	97·67
June 30, "	209,049,208.81	200,280,768.59	95·78
September 30, "	68,984,420.86	59,648,958.94	86·54
December 31, "	181,681,479.40	101,250,938.95	76·92
March 31, 1863.....	178,569,759.25	116,195,851.69	64·51
June 30, "	216,460,067.49	145,829,147.47	67·37
September 30, "	118,267,491.75	89,800,506.48	75·98
December 31, "	150,450,848.85	100,862,245.72	67·40
March 31, 1864.....	191,922,104.42	120,220,006.20	62·64
June 30, "	235,371,791.92	122,581,629.23	52·08
September 30, "	147,785,822.42	61,295,592.72	41·49
December 31, "	179,908,674.29	80,865,204.80	44·67
March 31, 1865.....	175,813,876.72	88,094,971.80	50·25
June 30, "	361,905,625.74	258,406,819.14	70·02
September 30, "	188,765,727.22	97,088,878.04	69·93
For the years ending—			
December 31, 1862.....	\$470,562,806.24	\$420,657,784.32	89·89
" 31, 1863.....	668,748,162.84	451,687,251.36	68·05
" 31, 1864.....	754,988,398.05	384,462,432.95	50·98
September 30, 1865.....	675,984,729.68	488,540,163.98	64·87
For the forty-five months of the war.....			
	\$2,565,238,591.31	\$1,695,347,682.61	66·09

It seems superfluous to comment on such figures as these. A treasury administration that permits the credit of a wealthy people to decline so that its obligations fall fifty per

cent and remain there for a year, can hardly be called successful. Yet the results here displayed, as also the forced circulation of treasury notes, follow naturally from the attempt to carry through a war by loans.

But the lesson of these public accounts is not fully appreciated until it is observed with what ease a system of internal revenue may be made to respond to a vigorous and decided administration, for this shows how unnecessary it is to rely wholly upon public credit for extraordinary expenditures. In this connection the following table is pertinent for our consideration.

Table showing receipts from various sources, for fiscal years, in denominations of millions.

	1861.	1862.	1863.	1864.	1865.	1866.
Customs revenue.....	89·6	49·0	69·0	102·8	84·9	179·0
Internal revenue.....	....	1·7	39·1	110·2	210·6	311·2
Miscellaneous.....	1·9	1·1	4·5	52·1	88·2	67·8
Clear revenue.....	41·5	51·9	112·6	264·6	383·7	558·0
From loans.....	23·7	438·6	595·6	696·0	864·8	92·6
Total revenue....	65·2	485·5	708·2	960·6	1,198·5	650·6

It requires no extended study to discover the meaning of these figures. The criticism which they offer makes its appearance when one asks what would probably have been the financial consequences could the receipts from internal revenue have been moved ahead two years. Suppose, for example, that Secretary Chase could have received from this source \$110,000,000 in 1862, \$210,000,000 in 1863, and \$311,000,000 in 1864; what a change would it have produced upon the course of financial administration! Its moral effect upon the South, working especially through her European sympathizers, would have brought the war to a more speedy termination, the credit of the government could not have suffered as it did, while the advocates of legal-tender money would have been deprived of the argument of necessity. Now the responsibility for the tardy flow of revenue from

internal duties is traceable to the policy upon which the finances of the war were set on foot, and not to the inability or the reluctance of the country to pay. Secretary Chase denied the necessity of meeting any part of war expenditure from war-taxes, because the financial theory which he espoused deprecated the endeavor; and it required nearly three years of disastrous treasury management to convert the administration and Congress from this erroneous theory. In view of actual conditions, it is perhaps a little extravagant to suppose that the receipts from internal revenue could have been moved ahead two years, but it is altogether reasonable to conclude that a vigorous administration might have anticipated actual results by eighteen months.

This estimate allows nearly a year for the establishment of the system, and claims only that internal revenue should have begun to come into the treasury at the rate of \$9,000,000 a month as early as July, 1862. And when it is noticed how quickly the industries of the country responded to the laws of 1861, as shown by the receipts for the year 1865, one can not regard this claim as at all impracticable. There is here disclosed the fundamental error of that theory which looks to credit as the only source of war expenditures. It is blindly optimistic, and so deprecates an appeal to sources of revenue that might with ease be opened. They who undertake its administration are sure to let matters drift until financial disaster awakens them to the fact that the financial problem is no longer under their control. This theory springs from financial ignorance, from a sense of administrative weakness, and from a thorough distrust of the people.

It appears, then, that the history of the war of 1861, like that of 1812, bears direct testimony against the sufficiency of the loan policy. It is no apology for the men who administered public affairs that they looked upon the Rebellion as a local insurrection, for, in matters of public financing, revenue must conform to necessary expenditure; and no policy can meet approval which fails to supply all the money that is needed for as long a time as it is needed.

What is the true plan for the financial management of a war?

Thus far our argument has proceeded according to the logic of exclusion. We have learned that the tax policy does not conform to well-known principles of human nature, and that the loan policy fails to bear the test when tried; but since taxes and loans are the only sources of revenue open to modern financiers, it follows that the true policy must embrace them both. Our further study, therefore, must concern itself with inquiring what constitutes a reasonable union of taxes and loans.

We shall be assisted in answering this question if we notice, at the outset, certain fiscal principles or truths that point to the correct theory of treasury management. First, the habit of bearing taxes is one easily acquired, if only the instruction be given in a proper manner. It is never necessary to depend altogether upon loans for war expenditure, and the administration that shrinks from a levy of taxes, lest the war spirit be chilled, shows either a doubtful cause or a weak-kneed cabinet. As a second principle may be stated the fact that it is easier to raise the rate of existing taxes than to establish a new system of duties. From this it follows that the germ of a war policy lies back in the treasury policy of ordinary times. Again, it is popular support, rather than the adherence of a syndicate of banks, which insures the success of a financial policy. This is true, because popular sentiment in favor of the administration guarantees the support of the banks, but it is not true that the support of the banks brings with it general enthusiasm. This does not mean that banks should never be employed as agents of the government, but that the administration should be superior to the criticisms of the banking interest, that the basis of its operations should be as broad as possible, and that it is no sign of weakness to appeal to patriotism as a motive for lending money. And, lastly, it is a truth worth remembering that democratic peoples are willing to go all lengths with a government which takes them into its confi-

dence. It is assumed that the purpose of the war is approved, otherwise there is no apology for undertaking it; but, granting this, personal sacrifice and assistance are assured to a government so long as the public continues to have confidence in the efficiency of its administration. The meaning of this fact is, that an adequate financial policy should be bold, courageous, sufficient, and simple; that it should lie close to the sympathies of the people, and not fear to make from them searching demands. We have now before us the raw material out of which to construct a plan for the financial management of a war.

Coming then directly to the question in hand, it is of prime necessity to recognize that good financing in times of emergency is only possible upon the basis of an adequate revenue system previously established. It has been already stated that some preparation in time of peace should be made against the advent of war, but that the assignment of a particular tax to this purpose, or the accumulation of a war-reserve, does not accord with the most perfect financial requirements.¹ How, then, may the peace establishment provide against unusual demands? Nothing more is required for this purpose than that the permanent system should be so adjusted as to respond quickly to any change in rates imposed, and this can be easily done by fixing the ordinary rate of taxation below the maximum revenue rate. But, if the actual rate of taxation in ordinary times be at or above the maximum revenue rate, the administration can hope for no assistance, in case of an emergency, from established taxes. Under such circumstances the government is embarrassed at the outset, and easily persuades itself that an appeal to credit is the only method for making headway against demands. But let it be supposed, on the other hand, that the country possesses a broad system of taxation, so that ordinary demands may be met by imposing light duties, any embarrassment encountered by the minister of finance at the beginning of a war must be of his own making.

¹ Cf. *ante*, pp. 84-95.

But, assuming such provisional measures to have been taken, what is the next step in an adequate war policy ?¹

Our answer may be given without hesitation. New sources of revenue must be opened by the levy of new taxes. But, it may be asked, is not such a proposal a virtual abandonment of the loan policy ? This can not be admitted ; for it is essential that a law should be passed to provide for clear revenue, in addition to that secured by raising the rate upon existing taxes, before a financier has any right to assume that he can borrow large sums without depressing public credit. He can not rely entirely upon the new revenue derived from the old taxes, because this revenue is not co-existent with the debts created. A true financial policy, also, must hold in view the termination of the war as well as its continuance, and do nothing which can in any manner obstruct the speedy reduction in the rate of permanent taxes upon a return of peace. For, if the extraordinary income from the permanent taxes be mortgaged to the support of a permanent debt, the first claim of a good revenue system is disregarded. The elastic quality of the system would be thereby destroyed, and the country would be poorly prepared to meet another fiscal emergency. And it must be further noticed that these new taxes, once established and brought into running order, are ready at hand to assist in the expungement of debts when the war shall have terminated. It thus appears that the new taxes tend to strengthen public credit, even before they become remunerative ; they relieve the temporary revenue derived from permanent taxes, so that it may again serve as the temporary basis of new loans ; and they assume the whole weight of the debt upon a return of peace.

It may be objected to the plan here proposed that, should the struggle prove of slight duration and little cost, the coun-

¹ Were this question asked for the United States, the answer might be given more explicitly. In view of the peculiar relation existing between the Federal government and the several States, there are many reasons for saying that this first tax should be a direct tax upon the States, apportioned and collected on the principle of "revolutionary requisitions."

try is burdened with useless taxes; but this objection seems to be made without due consideration. Assuming the difficulty to be quickly terminated, it is more than probable that the strong financial policy adopted by the administration rendered great assistance in attaining so desirable an end. If a destructive war can be obviated by the voting of taxes, there are few who would withhold their assent. Nor is it necessary, in the case assumed, that the taxes should prove an actual burden to the people. New taxes require some considerable time before they become productive, and, should the occasion for them pass away, they may be abolished before taking much from the pockets of the people. Let, then, no financier argue that war-demand will probably be small, and that it may be met by loans without an appeal to taxes; for the administration certainly needs the moral influence of the tax-laws, the revenue which these laws are capable of bearing may be required, and, if the events show the solicitude of the administration to have been groundless, no great harm is done.

It remains for us to consider what use should be made of public credit, and to discover the principle according to which the extraordinary expenditure should be apportioned between loans and taxes. The theory of public borrowing is very simple. Public credit should always be regarded as a means of anticipating revenue. It is a short cut to capital, and the first great service of loans in time of war is to give the administration immediate control over capital upon the declaration of hostilities. But such borrowing does not necessarily create a permanent debt. It rests, in the first instance, upon the extraordinary receipts arising from the increase of rate in the permanent revenue system. Should the war, however, continue for any considerable time, it would be necessary to convert the debt thus created into a permanent or time debt, and assign it to new funds for support. And here, it may be said, is the only point at which ignorance of the probable duration of the extraordinary demands may be permitted to influence the financial policy of

the administration. It is proper, until the future may be forecast with some degree of certainty, that temporary debts rather than permanent debts should be used. And here, too, is disclosed the peculiar service rendered by an elastic revenue system, for the quick command which such a system grants over revenue provides a solid basis of credit at the beginning of a war, and so insures a good price for the first bonds negotiated.

But there is another and more important service that may be rendered by loans. When a government gives bonds in return for capital, the individual who supplies the capital does not feel that sense of personal loss which attends the payment of a tax. He has merely changed the character of his property. It thus appears that by means of loans a government may hope to secure immediate control over large funds of capital while yet allowing the motives for continued industry full liberty of action. So far as it seems necessary to use credit for attaining this end, the obligations created against the state must run for some considerable time, and be assigned to a reliable fund for the payment of the annual interest which they demand.

In the services here brought to view lies the entire theory of public credit. Loans are always a means of anticipating assured revenue. No other meaning can be attached to them when used to carry through the financial operations of a war, for no system has yet been devised for evading the necessity of extraordinary taxes as the result of extraordinary expenditures. Our general conclusion then is, that sound financial management inclines always toward taxes. The measure of the amount that may be secured by this means is found in their observed effect upon current industry, for the demand for clear revenue must never go so far as to discourage industrial activity.

It is impossible to proceed much further in a general discussion of this subject, for the conflicting interests to be harmonized, and the varying importance of the factors that enter into the problem, must influence greatly the applica-

tion of the principles suggested. It may, however, be permitted to take one step in the direction of formulating a rule of wide application for the financial conduct of a war, by which the relative use to be made of taxes and loans may be roughly indicated. At the beginning of hostilities, revenue from loans may properly outbalance revenue from taxes, but, as the war progresses and the demands increase, taxes should be continually forced into greater prominence. There are several considerations that favor this rule. Thus the necessity for temporary loans is always greater at the beginning of a war than at any subsequent period. As the newly levied taxes become more and more productive, and as the people become accustomed to high rates of payment, the legitimate use of loans is narrowed. But the most forcible reason favoring the rule is the following: The greatest stress which the advent of a war throws upon industries arises from the necessary re-adjustment of labor to new lines of demand. It is this point which is not duly appreciated by writers upon finance. They do not perceive that the strain upon a treasury policy comes at the beginning of a war. A condition of war is not a condition of peace from any point of view, and the industrial transition from the one to the other is always attended with danger and may prove the occasion of disaster. But, if the financier can only bridge over this chasm and establish business firmly on a war basis, he may extend his taxing system with as much confidence as if the people were living in a state of profound peace. It is during this period of re-adjustment that public credit renders its greatest service to the administration. At no future time during the continuance of a war can such strong reasons be urged in favor of its employment.

It seems, then, that the theory for the administration of a treasury during the continuance of a war contemplates, first, the formation of a financial policy at the time when hostilities are first declared; and, second, the development of the policy after industries are well adjusted to belligerent conditions. And, as has been set forth in the foregoing analysis,

the formation of the policy demands the legalization of three fiscal measures.

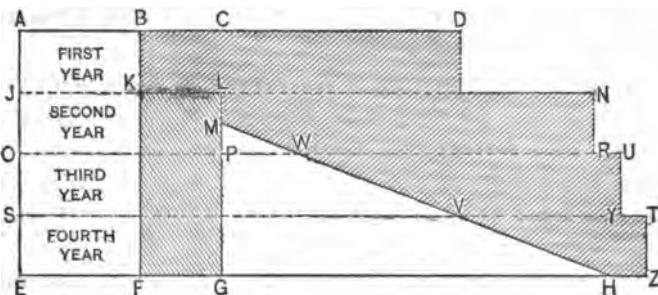
1. The rate of taxation in the permanent revenue system must be raised. The new income thus secured will serve as the basis of the first loans, and, when relieved by other funds, may be employed as a contingent fund or as a source of war expenditure. Nothing must be done to endanger the repeal of this measure upon a return of peace.

2. New sources of revenue must be opened by the levy of new taxes. The estimated proceeds of these taxes must exceed, if possible, the demands of loans for interest payment. This will assist in maintaining the credit of the state, it will give some revenue for war purposes while hostilities continue, and will provide revenue for the expungement of the debt when the demands for war expenditure shall have ceased.

3. A large loan, equal to the satisfaction of all possible demands, must be authorized, and the minister of finance must be granted large discretionary powers in its placement. In this manner there is created the machinery for financial operations, and under a strong administration there is little fear of failure.

The principles which control the development of the policy are the same as those which shaped its establishment. If temporary loans were resorted to, they should be funded upon the proceeds of the new taxes as soon as possible. The financier may hope for assistance from his new taxes within eighteen months of their levy, and, if demands continue to expand, his call for clear revenue should be gradually increased until revenue machinery be speeded to its highest productive capacity. But there is a limit to possible war consumption, and, with a gradually increasing income from taxes, clear revenue must eventually overtake any possible demand.

This theory of treasury management may, perhaps, be more clearly apprehended if stated with the assistance of the following diagram :



In this figure the horizontal lines, in the direction from left to right, measure the productivity of revenue machinery, while the perpendicular distance from the top represents the time through which it operates. Thus the line *A B* shows the intensity of the demand made upon the permanent revenue establishment in time of peace, and, since the line *A J* covers one year's time, the parallelogram *A K* represents the normal income for a year. The first measure upon the outbreak of a war should be to increase the rate imposed upon the peace establishment. Let it then be increased by *B C*. If, now, the permanent system has been formed according to correct principles, and is elastic in character, this advance in the rate of imposition will yield increased revenue; but, since it is necessary to properly advertise such a change, it is assumed that this addition to clear receipts will not make its appearance till the beginning of the second year. It follows, then, that the entire war demand of the first year must come from loans. This is represented in the figure by the parallelogram *K D*. There is no danger, however, but that this stock will bear good prices, because it rests upon income assured by revenue machinery already in operation. The fund, which sustains the credit of the government during the first year, is represented by the parallelogram *K P*, from which it appears that the entire receipts flowing from the permanent establishment during the second year is equal to the parallelogram *J P*. During the second year, also, the newly established taxes begin to lend their assistance in car-

rying on financial operations, and the income from this source is represented by the triangle $M P W$. This revenue is shown as beginning in the middle of the second year, because it will probably take eighteen months to bring an entirely new system into working order. It thus appears that a large share of the extraordinary expenditure of this year also must be secured from loans, which is represented in the diagram by the figure $L M W R N$. But with the beginning of the third year it may be assumed that the industrial re-adjustment has taken place, and the financier may constantly and persistently extend his demand for clear revenue; and, since there is a limit to war consumption, the necessity of loans decreases with every increase in clear revenue. Thus the total revenue for the third year is represented by the parallelogram $O Y$, of which clear revenue provides a sum represented by the figure $O S V W$ the remainder being supplied by loans. In the fourth year, of a total expenditure represented by $E Z T S$, loans are called upon to furnish the comparatively small sum of $V H Z T$. It lies as an essential part of the treasury policy here defended that the newly established system of taxation should be continuously expanded until financial exigencies shall have passed away; and this may be brought about either by a return of peace or by the fact that clear revenue has overtaken war demands. It is useless to say that this is impossible: it is perfectly feasible, provided only a strong and vigorous policy be adopted at the beginning of the war. The difficult part of the task imposed upon the financier is during the first and second years of the war. At this time there is demand for wisdom and firmness, for no administration can recover itself if it indulge in weakness and inefficiency at the time when a policy is set on foot.

Our conclusion, then, respecting the appropriate financial policy for the conduct of a war is the following: Reliance can not be placed wholly upon loans nor wholly upon taxes, but fiscal administration should be so adjusted as to gradually change the burden of expenditure from credit to clear income.

CHAPTER II.

CLASSIFICATION OF PUBLIC DEBTS.

THE eminent French financier, M. Leroy-Beaulieu, submits two classifications of public debts—the one pertaining to the fundamental character of the debt, the other to the conditions of the contract. In the former, the character of a debt is determined by the motive upon which the government relies for securing money; in the latter, questions of time, of principal, and of interest present themselves for consideration. It is my purpose, in the present chapter, to follow out the classification here suggested, and to call attention to certain technical problems that naturally arise in the course of creating a great national debt.

Consideration of Debts as regards their Fundamental Character.

Our study need not be long detained by a consideration of patriotic loans. They can not form a permanent part of a financial policy, for the motive upon which they rest is spasmodic and uncertain rather than steady and reliable. It is true that an administration may avail itself of popular enthusiasm for a popular cause, and sell bonds in larger amounts or on more favorable terms than would be possible under ordinary circumstances. Nor is it derogatory to the dignity of the financier that he avail himself of such a state of the public mind, but he must regard the conditions in which this is possible as a gratuity of fortune, and make his appeal for assistance when popular enthusiasm is at its flood, for to arouse this at will is beyond the power of any man.

Forced loans, as they are known to the science of finance, rest upon the desire common to all men to escape a threatened evil. A full account of this method of filling a depleted treasury would make a long chapter in financial history, for plans of extorting money under the guise of loans are as numerous as they are curious. Our present interest, however, is confined to the issue of legal-tender notes, since this is the chief method of enforced borrowing practiced by modern governments.

But in what manner, it may be asked, does an issue of legal-tender notes constitute a forced loan? To answer this question it will only be necessary to call attention to the manner in which such notes are put into circulation. The government being in need of commodities, and having no money to pay for them, goes upon the market, buys what it wants, and gives in return a written promise to pay. So far the transaction seems to be one of simple credit. But it should be noticed that, if this promise of the government were a simple note of hand, there is no likelihood that dealers would care to secure the government as a customer. It is essential that dealers should receive such payment as will enable them to meet their own business obligations. In order, then, to relieve those individuals from embarrassment who in the first instance supply the state with goods or services, the government, acting in its capacity as a sovereign, attaches to its notes the legal power of paying private debts. Reduced to plain language, this means that all men must receive public notes or suffer the penalty of refusal. The universal acceptance of such notes rests upon the fear which men entertain of incurring the displeasure of the government; for, by declaring its promises to be a legal-tender in payment of private debts, the government virtually threatens to withdraw full protection in matters of contract from every man who refuses to assist in floating its notes. As viewed by the government, the issue of these notes is the placement of a debt, since by means of them it secures immediate control over commodities in return for a promise of future payment; as viewed by the

public, it is the forced placement of a debt, since no man, unless he choose to retire from business, can elude the necessity of delivering goods for these notes.

It is no part of the science of finance, strictly regarded, to consider the argument against an irredeemable paper money, and yet that argument is so simple that it may be presented in a single sentence. It is safer, in the long run, to trust nature to determine the proper amount of money in circulation than to place that power in the hands of any legislature. Especially during a period of war, when the temptation to inflate the currency is the strongest because the pressure upon the public treasury is the heaviest, should the educated sentiment of a country most strenuously oppose resort to such a delusive method of financing. The issue of inconverntible paper money is most certainly delusive, because a redundant and local currency adds unnecessarily to public burdens, and because, resting upon the coercive power of the state, it in reality is a tax under the guise of a loan.

There is no financial argument in favor of an issue of legal-tender notes except the erroneous one that in this manner the government eludes the necessity of paying interest upon such capital as it may borrow. It is true that a small amount of convertible notes may be issued in excess of the coin held for their redemption, and there is no reason why corporations rather than the public should reap the advantage of such an issue. But this is quite a different measure from the collection of capital by means of a forced circulation of paper money. A note convertible into coin need not be clothed with legal power of paying private debts, for it readily passes by virtue of the value it represents. Nor can there be any necessity of making treasury notes a legal tender except they be issued in excess of the general demands of trade. From this it appears that, when a government decides in favor of forced circulation, it takes a step leading inevitably to the inflation of general prices, and to the depreciation of its own obligations of every sort. But, since all these obligations must be redeemed in specie, the premium that comes

to the creditor at redemption amounts for all practical purposes to a payment of interest on capital borrowed.

Still it may be urged that legal-tender notes are preferable to bonds bearing interest; for both alike suffer discount, but by means of the former the treasury escapes all demands until the government sees fit to make payment of the principal. Such a position might be tenable were it not that the indirect evils entailed by an inflated currency more than overbalance any relief that may be experienced by avoiding the temporary payment of interest. The discount upon bonds, which is here used as an argument for the issue of notes, is in large measure traceable to a lack of confidence which a resort to legal-tender notes throws upon treasury administration. It is childish to claim, as did Secretary Chase, that bonds are placed at par because sold at par in depreciated paper. Bonds payable in specie must partake of the discount of the paper with which they are bought. It should be held firmly in mind that a resort to forced circulation is only necessary when the circulating medium is redundant, and from this it follows that every new issue of notes, inflating yet further the currency, will increase the discount upon bonds. It is believed that every sound principle of finance and economy stands opposed to the employment of notes which rely upon their legal power of paying debts for their ability to circulate; and, as was shown in the previous chapter, their use is confession on the part of the administration of financial incompetency.

Omitting further consideration of patriotic and forced loans, the administration may, in the third place, rely on voluntary loans as the basis of all operations in public credit. In this case men are induced to place their capital at the disposal of the government, because it appears to them to be a profitable form of investment. This commercial motive forms a good basis for fiscal transactions, because it is steady and reliable. It is for this reason that voluntary loans must be accepted as the only permanent and satisfactory foundation of credit transactions. Under the existing condition of

legal and personal rights, this is a self-evident financial truth. We need not, therefore, spend time in arguing for voluntary loans, but may proceed at once to consider various questions that arise in connection with the form of contract entered into between the state and its creditors.

Technical Questions pertaining to the Creation of a Debt.

So far as the conditions of the contract are concerned, public debts may be either floating or funded. That which distinguishes the one from the other is perhaps rather the grade of the obligation, considered as commercial paper, than any peculiar wording of the contract. All floating debts, and there are many sorts, lack the essential element of first-class commercial paper ; they do not bear upon their face evidence of their own genuineness ; they are not negotiable, but are of the nature of running accounts any item of which may be contested. Due-bills, warrants, commissary certificates, orders from the general of an army upon the treasury, such are the sorts of obligations that go to make up a floating debt. It is true that speculators may buy such accounts, but the government retains the right of investigating each particular claim. This is not true of a funded debt. When the government has placed a bond, it no longer retains the reserved right of making inquiry concerning the service rendered. A bond is itself evidence of a valid claim, and the language in which it is written expresses the extent and nature of that claim.

May the minister of finance consider favorably the employment of floating debts ? One can not reply that floating obligations are wholly at variance with the requirements of sound financing, for many cases arise in the administration of a public treasury when their use is absolutely imperative. For example, during the prosecution of a war it frequently becomes necessary for the commissariat to issue warrants in payment for supplies, or for a commanding general to write an order upon the treasurer in payment for horses impressed into the service. In ordinary peace administra-

tion, also, temporary debts are frequently necessary for the settlement of claims and running accounts.

But, though floating indebtedness may not be wholly avoided, the leanings of an administration should be always toward funded obligations. Many reasons might be presented in favor of this rule. Thus, for equal amounts, a floating debt rests more heavily upon public credit than a funded debt, because of the uncertainty and confusion which it is likely to introduce into public accounts.

Again, for equal amounts of commodities secured, it is more expensive to deal with floating than with funded debts, and the rate of final expense increases with the age of the obligations. The explanation of this is that, when a man has a claim upon a government, he is apt to put it as high as possible, and the longer this claim runs without being adjusted, the more extended will be his demands. His memory will probably hold firmly all the facts in his own favor, while the longer the time intervening between the service and the settlement, the more difficult will it be to secure rebutting testimony. Or, if one consider such floating debts as arise from army impressments, where an estimate of the amount due is made at the time goods are taken, it can not be denied that the price paid will be higher than if the commodities had been bought with cash in open market. Or, were we to consider municipal and local financing, the reasons against the use of floating debts would appear in a yet stronger light; but sufficient has been said to lead to the conclusion that sound financing inclines always toward funded obligations, and will liquidate floating accounts with all possible speed.

Passing, then, to a consideration of funded obligations, the completed classification of debt paper is suggested by the two following questions :

Is there any mention, in the contract, of the sum of money given over to the government at the time the obligation was created? If there is no such mentioned, and the contract is simply a promise to pay yearly or periodically a stated

sum, the debt is regarded as an annuity ; if, on the other hand, there is such a mention, and he who buys the evidence of debt buys the right to reclaim the amount originally paid, together with an annual payment of interest, the form of the obligation is that of a common note, called by various names in various countries. In this essay such notes are termed bonds.

The second question asks if the contract states when the debt must be paid ; and, provided such a statement exists, whether a definite time is mentioned for such payment and definite conditions prescribed, or whether the whole matter of reimbursement is left to the choice of the government. This consideration of time shows annuities to be of three sorts : those drawn to lapse at some specific time, called terminable annuities ; those drawn to lapse at the death of the annuitant or some stated number of his assignees, called life annuities ; and those drawn to run in perpetuity, or perpetual annuities. Bonds also may be drawn so as to establish what are technically known as time debts, or perpetual debts ; but so various are the other conditions to which they conform that it will be more satisfactory to allow their further classification to emerge from a discussion of certain technical questions that always arise in the course of contracting a debt.

I. Shall the financier strive for uniformity or admit of variety in the placement of debt-paper ?

This is the first question that arises in the establishment of a debt system. It may be well to remark at the beginning that complete uniformity is impossible. Under certain conditions, floating debts must be made use of, and there is no reason to suppose that in the placement of funded obligations the same conditions will always continue. In the previous chapter it was shown that, during the prosecution of a war, the character of the financial problem changed with every successive year ; how, then, may one hope that the sort of debt paper most highly successful under one set of conditions will serve equally well for other circumstances ?

The advocates of uniformity would probably admit of so much variety as is here suggested, but would argue for a uniform consolidated debt. Their defense of such a conclusion would be that diversity of debt paper introduces confusion and obscurity into public accounts, and in consequence weighs heavily upon public credit. As stated by an American writer, "A public debt, to command confidence, should be simple in its plan, easily understood, of one kind, and without contingencies."¹ This seems to be one of those cast-iron rules so frequently promulgated by men who look only on one side of a question. A guarded variety in public obligations tends to strengthen public credit, because it permits the financier to conform to the differing needs of money lenders. To adopt the strict rule of uniformity would show the same disregard of business principles as if a merchant should keep on hand but one pattern of calico. Moreover, it is a mistake to suppose that variety necessarily throws public accounts into confusion. It may be carried so far as to introduce complexity, and give rise to a want of confidence. Previous to 1870 the finances of the United States were open to this criticism. There were at that time twelve sorts of notes bearing 6 per cent interest, five different kinds of five-per-cent notes, and five sorts of 7-30's. An extreme application of the principle of variety like this should be avoided, but the policy of granting the minister of finance no latitude would frequently force him to close with bargains less advantageous to the government than the necessities of the case require. A moderate variety of debt paper, therefore, may be admitted into a good debt system; for by meeting the known wants of the several classes of investors the market for stock will be extended, and the competition among buyers will tend to raise the credit of the government.

II. Which form of contract is the more advantageous to the public—one that binds the government to an annual pay-

¹ J. S. Gibbons, "The Public Debt of the United States," p. 25.

ment of a definite amount, or one that calls for interest-payments until reimbursement of the sum originally borrowed?

This question brings into comparison the relative claims of annuities and bonds. In the seventeenth and eighteenth centuries annuities were quite generally defended by financial writers and adopted by governments. This followed naturally from the system of economic thought then prevalent, which taught that the payment of interest upon a debt held within a country could not possibly be the source of injury to the people. There are many expressions of this opinion to be found in the writings of the times.¹ According to Pinto, public debts increased national wealth by the whole of the capital which they represented. Bishop Berkeley called public debts a mine of gold. Melon, who was a Mercantilist writer of importance, regarded the payment of interest entailed by a public debt as passing money from the right hand into the left. Voltaire declared that no people could become impoverished who paid interest only to themselves. Under the direction of such ideas it is no occasion for surprise that annuities should have been preferred to ordinary bonds. By means of them the government secured a large sum of disposable capital on the basis of a slight increase of the tax-levy; and, so long as the creditors remained citizens of the debtor state, it was thought that a people could not be impoverished by the annual payments. But at present this old theory of public debts has been abandoned. It is now admitted that the distribution of wealth within a country is of as much importance to its public economy as the possession of wealth; and, since it has been recognized that the payment of an annuity out of taxes is the payment from one set of citizens to another, the whole question of public obligations is thrown into a different light. It is these clearer ideas with respect to interest-payments that have deprived annuities of their strongest defense.

But the chief argument against annuities is found in the

¹ "Traité de la Science des Finances," Leroy-Beaulieu, vol. ii, p. 199.

fact that a contract of this form once delivered lies beyond the control of the government. It can not be re-adjusted to conform to changed conditions of the money market. There are two ways in which this fact subjects a government employing annuities to loss. In the first place, annuities do not permit any reduction in the rate of interest paid in case the market price for money falls below the price at which the debt was originally contracted. Had the debt, on the other hand, been drawn in the form of a bond, any fall in the price that must be paid for money would have permitted the government to place a new loan at reduced rates, and with its proceeds to have extinguished the old debt. This would have occasioned a direct saving equal to the difference in annual payments required; but the government that makes use of annuities when creating a new debt is deprived of the opportunity of such saving.

The second loss entailed by annuities (we here consider perpetual annuities only) makes its appearance when a government undertakes to extinguish its obligations. A permanent annuity can only be paid by purchase on the market, and the price demanded will be equal to the capitalization of the yearly payment, computed on the basis of the current interest. It follows from this that, in case money falls in value, the price of an annuity must rise in a corresponding degree, and the government that undertakes to free itself from debt will be under the necessity of paying a premium for every annuity purchased. Had the debt been contracted in the form of a bond, the loss occasioned by the payment of this premium would not have been entailed. It is for these reasons that annuities have been quite generally abandoned as a means of placing new loans.¹

¹ The facts here presented may be rendered perfectly clear by a comparison of the following cases:

CASE I.—A government borrows \$20,000, in the form of bonds; at 5 per cent interest; the yearly payment would then be \$1,000. Suppose the rate of interest falls so that the bonds may be converted into three-per-cent, the yearly payment falls to \$600, and the annual saving to the public is \$400, the principal remaining unchanged.

III. What may be said respecting the element of time as a factor in credit contracts?

A consideration of the element of time introduces a vast variety of debt paper. The study of the present paragraph, which pertains altogether to bonds as distinguished from annuities, will bring to our attention the following species of obligations: Temporary debts, perpetual debts, debts payable at the expiration of a specified period, limited-option debts, and debts payable by installments. It should be remarked that these stipulations regarding time of payment pertain to the principal rather than the interest of the obligations, and also that a contract may prohibit a government from payment as well as grant creditors the right of demanding reimbursement.

There is no strict rule according to which a temporary debt may be defined. A deposit payable at ten days' notice is certainly a temporary obligation, while a bond running forty years will be denied that character; but at what point the one passes into the other it is difficult to say with assurance. It seems that this question ought to be decided differently for different countries, according to the organization of their respective governing bodies. In general, a debt that calls for payment by the administration that incurs the obligation may be termed a temporary debt; while one that outlasts the most radical changes in the actual governing body for

CASE II.—A government borrows \$20,000, in the form of annuities, when interest is 5 per cent. Assuming the annuity to be perpetual, the amount to be annually paid, and which is specifically stated in the contract, may be assumed to be \$1,000. In case interest falls to 3 per cent, the government must continue to pay each year \$1,000. Thus the first loss sustained by the state is the opportunity of saving annually \$400. The second loss makes its appearance when the government undertakes to purchase its own obligations for the purpose of extinguishing the debt, for an annuity at any time would be worth its capitalized sum at the current rate of interest. That is to say, an annuity of \$1,000, when interest is at 3 per cent, would be worth \$38,333. Thus, in addition to the lost opportunity of lightening the burden of the debt while it lasts, there is to be reckoned the actual loss of \$18,333, which must be drawn from the proceeds of taxes in order to pay the bond, in excess of the sum originally borrowed.

which the constitution provides can not properly be so classified. Upon the basis of this distinction, it appears that the extreme limit of a temporary loan in the United States would be four years; not alone because the executive must be changed once in four years, but also because it will probably require that time for any radical modification in public sentiment to find its way into the composition of Congress. So far as I am aware, this country has never put out a four-year bond, her temporary loans having varied from deposits on call to three-year credit paper.

But what is the meaning of temporary obligations, and when may they be properly employed? There are three interpretations that may be given to them, and three sets of conditions that justify their use. Thus, temporary debts may be systematically employed by an administration that has adopted the policy of deficit rather than surplus estimates; they may be properly resorted to when a tax-loan is to be issued; and they may be also used, though with great caution, to make headway against the first stress of a sudden emergency.

Attention was called in a former chapter to the evil consequences that flow from administering a public treasury in the presence of surplus revenue, and the conclusion was there reached that the appearance of a constant deficit in annual appropriations may be evidence of close estimates, and not of bad financing.¹ It was also pointed out that the danger in ordinary deficit financing lay in the temptation, which must certainly present itself, of funding instead of paying the obligations so incurred. To guard against the growth of permanent claims, it should stand as an invariable rule that the principle of temporary indebtedness must attach to all financial operations of this sort. It is true that this policy contemplates the constant creation and constant expungement of public obligations, but one who objects to it for this reason does not understand its claims. The funda-

¹ Cf. *ante*, p. 80.

mental truth upon which it rests is that, in the long run, income from taxes must meet expenditure, but that there will probably be temporary discrepancies leading to deficits. These deficits might be obviated by underestimating revenue, but both analysis and experience declare such a decision to be unwise. It is better to make estimates close, and borrow to cover any discrepancy. In reality, therefore, the policy of temporary debts, which is here advocated, is merely a systematic method of throwing the deficit of one year on to the surplus of another; and if adequate provision for the debts of any given year be made in the ensuing estimates, the benefits of deficit financing will be secured, while the country incurs no danger of a constantly growing debt. It is then possible to interpret the presence of temporary debts, as evidence of close appropriations and accurate estimates, and one may rest assured that, when they are thus employed in the interest of good budgetary financing, the saving in estimates will more than balance the slight payment which they entail in the form of interest.

Those temporary debts called "tax-loans" may perhaps be the best understood through the analogy of common bills of exchange. The meaning of a mercantile bill is, that goods capable of discharging the sum declared due are on their way to the consumer; and that, upon the final sale of such goods, a fund is established, from which all claims arising in the course of their production may be at last settled. Thus, a bill is evidence of a claim upon the proceeds of a sale. To discount a bill, therefore, is to anticipate payment from a fund that, in the ordinary course of trade, is sure to arise. In like manner the placement by the government of a tax-loan is the method which it adopts of discounting assured revenue. The only purpose of such a loan is to anticipate a specific income. The principal of such debts can not be greater than the sum which must shortly accrue to the public treasury, otherwise they lose the essential characteristic of tax-loans.

The financial records of the United States offer no more

perfect example of obligations of this sort than is presented by the direct tax-loan of 1815.¹ It will be remembered that the endeavor to carry on the war of 1812 without directly appealing to the resources of the country had at this time been confessed a failure; and that Mr. Dallas, who was called into the cabinet as Secretary of the Treasury, proposed a vigorous system of taxation.² But the pressing needs of the government could not wait the ordinary course of newly-levied taxes; a loan, therefore, of \$6,000,000 was authorized, and the contract declared that this sum should be paid out of the first proceeds of the direct tax. Here is presented the true character of a tax-loan: it must be temporary; indeed, it is not understood until recognized as a subordinate part of a system of taxation. An administration will seldom find itself in circumstances calling for its use, but it may, under certain conditions, be of great assistance to the minister of finance.³

In the third place, temporary debts may be regarded as indicating that the administration has experienced some unusual demand for money, which it believes to be of a transitory nature. This may result from a deficit in the accustomed revenue, traceable to some passing disorder in commercial relations; or it may arise from the necessity of providing immediately for some extraordinary service. In either case, the considerations that favor the use of temporary loans vary with the strength of the expectation that the demand will be transitory. The arguments which favor this conclusion have been already presented. Sudden changes in the established tax-rates are undesirable; running accounts and unsettled claims are in the highest degree pernicious;

¹ January 9th.

² Cf. *ante*, p. 128.

³ The same principle applies if the loan anticipates any other source of revenue than that arising from taxes. For example, in 1814 (March 31) bonds were issued to indemnify certain claimants of public lands in the Mississippi territory, which were redeemable out of the proceeds arising from the sales of such lands, after necessary public expenses had been covered. There are, however, but few instances in which the United States government has mortgaged specific revenue for specific obligations.

long-time debts are unnecessary; short-time obligations are all that remain to the financier, and fit well the demands of good treasury management.

Still, the financier should recognize that, in employing temporary obligation under such circumstances, he stands upon dangerous ground, for he is calculating upon a future that is quite uncertain. All debts contracted to make headway against sudden demands should be drawn so as to outlast the emergency that calls them forth. As an illustration, the expenditure occasioned by an Indian war might well be met by paper running two or three years, for such a war could not possibly encroach upon the resources of the treasury, and there is little danger that it would lead to foreign complications. But, when half the people rise in revolt, or when a quarrel touching the interests of European states is forced upon the administration, it is not wise to rely too confidently upon a speedy termination of difficulties. The use which Mr. Chase made of temporary debts at the beginning of the late war is open to just criticism. In the first nine months of his administration there were received into the public treasury, to the account of loans, \$192,200,000, and of this amount only \$45,700,000 was contracted on sufficiently long time to outlast the war. Two loans of \$50,000,000 each fell due just when the pressure upon the public treasury was the most severe—the one upon August 19, 1864, the other upon October 1 of the same year. It needs no remark to show that the unwillingness of the administration to recognize that it had a war on its hands constrained the Secretary to press unduly the claims of temporary debts, and to unnecessarily complicate the financial problem with which he was obliged to deal.

Assuming, then, that temporary obligations may with propriety be employed, their purpose will perhaps be best served by treasury notes bearing a low rate of interest. The presence in the community of a moderate amount of such paper, which may quickly and quietly be bought and sold, is of great commercial convenience, and this fact insures its

acceptance upon favorable terms. These notes, however, should be so drawn as to serve the purpose of banking paper and temporary investments, and should never be of such small denominations as to find their way into retail transactions. The reason for this is that the administration would otherwise incur the danger of injuriously affecting the circulating medium of the country by means of its treasury operations. Subject only to this restriction, public convenience should determine the form of treasury notes, for the wider the market which they find, the greater is the assistance which they are able to lend in supporting the credit of the government. Thus, certain United States notes, issued during the late war, were charged with 7·30 per cent interest, because that rate, computed upon a note of \$50, amounts to one cent per day ; their circulation, therefore, was not obstructed by cumbersome calculations of interest. These notes could change hands twenty times a day without calling for a set of interest-tables. It is quite common, also, to clothe treasury notes with the power of paying government dues. This certainly assists in securing for them an extended circulation, for under such a stipulation they partake of the character of a tax-loan. Indeed, the only difference is that treasury notes receivable for taxes are accredited to general taxes rather than to a special tax. These minor points can not be with safety overlooked by the financier who would attain the highest success as a fiscal administrator.

It is not, however, necessary to rely upon treasury notes as the only form of temporary debts. It may be advantageous for an administration to accept money as deposits on call, or at short notice, and pay therefor a low rate of interest. At one time during the administration of Secretary Chase the government was responsible for obligations of this sort amounting to more than \$100,000,000. Much may be said in favor of such a measure, especially if the government unite under its direction the policy of deficit financing and the control of a national bank. For, under such circumstances, deposits in the public bank might be used to cover

running deficits, and the government would thus be enabled to discount its own bills. The important question for the financier who accepts deposits on call pertains to the rate of interest that should be paid. Without entering into a discussion of the relation that exists between a public bank and private banks, it may be said that this rate should never be so high as to draw capital from ordinary business investments, or to throw upon the hands of the government more money than can be used in the ordinary course of its business. And from this it follows that the treasury authorities should retain the right to change at will the rate of interest paid, for it would otherwise be impossible to regulate the amount of money charged against the state as temporary obligations.

The general principles that should control in the administration of temporary indebtedness have been presented in the foregoing discussion. So far as the United States is concerned, with its policy of commercial isolation realized in the independent treasury, and with its policy of surplus financing, springing directly from the desire for industrial protection, the question of temporary debts is of no importance except when the administration is pressed by some great financial emergency. That is to say, this country has made the most use of temporary obligations at that time when their use is the most dangerous, and has refrained from appealing to them under those conditions when their employment would be of the most marked assistance in the administration of public finances.

As distinguished from temporary obligations, stand those debts so drawn as to continue for some considerable time. Here are introduced for our consideration debts which run in perpetuity, as well as those which become redeemable, or demand payment, at some specific date. One should not be misled by the expression perpetual debt. Such an obligation is not one that can only be extinguished by purchase, but rather one whose contract mentions no time at which payment may be demanded, and fails to guarantee the investor against repayment of the principal for any definite

period. Reference may be made, for purpose of illustration, to the three-per-cent stock created by the first Congress to assist in refunding the Revolutionary debt. This stock was made redeemable at the pleasure of the government, and consequently conformed to the requirements of a perpetual debt. Other instances of debts drawn upon this model are quite rare. Indeed, one is warranted in saying that perpetual debts pure and simple belong to Federalist administration, for since 1801 there are but three instances of loans of this sort.

From the time when the first Republican party came to power until the second Republican party assumed control of the National government, an altogether different principle seems to have controlled in fashioning debt contracts. The obligations of this period stipulate that the creditors shall, for a stated number of years, be secure in the enjoyment of their investments, but that at the expiration of this period the debt shall become redeemable at the pleasure of the government. For the most part, the date at which the bonds become re-imbursable is stated in the text of the law which authorized them; as, for example, the loan of 1848 was declared to be re-imbursable at any time after twenty years. There are, however, variations from this most simple form of contract. Thus, the law authorizing the six-per-cent loan of 1816 forbade the administration to enter into any engagement or contract which should preclude payment at any time after December 31, 1827. In such a case as this, the empowering act names the most extreme date for which Congress deems it advisable to sign away its privilege of redemption; and the financier, understanding the spirit of the law, should endeavor to make the actual time agreed upon less than the limit granted. From one point of view this is an advantageous way of placing a debt, for it gives

¹ These cases are: A loan of \$7,000,000 authorized April 10, 1816; a loan of \$3,000,000 authorized May 20, 1820; and certain stock issued in lieu of "bounty-land scrip" to the soldiers of the Mexican war. Cf. Act of February 11, 1847, sec. 9.

the administration an opportunity to fashion its obligations to the expressed wishes of customers; but the variety of debt paper which must in this manner be introduced, leading to complexity of accounts, will more than counterbalance any such advantages.

But, returning to the question first suggested: What is the essential difference between a bond re-imburseable from the date of its issue and one the redemption of which is denied for ten or twenty years? This distinction, which upon its face appears to be very slight, is one of the most fundamental that presents itself in the entire course of credit operations. It can not be understood until traced back to the policy respecting the ultimate payment of debts with which each form of contract stands in harmony. A bond re-imburseable from the date of its issue shows great carelessness on the part of the administration as to ultimate payment; on the other hand, a bond guaranteed against immediate payment is evidence of an intention to escape the evils of perpetual indebtedness. This is not difficult to understand when it is noticed that money lenders desire some permanency in investments,¹ and if the government will not guarantee this in the contract they will themselves secure it by refusing to pay full value for the bonds. They know well that a government which sells its obligations at eighty cents on the dollar will not be likely to make quick payment at par; and, reasoning from this fact, if the government insists upon the right of reimbursement at pleasure, they demand a bond bearing a nominal interest so low that it may be placed upon the market at discount. It is sometimes said that Mr. Hamilton believed in a perpetual debt, and when one notices the form into which he threw the obligations of the United States, the only escape from this conclusion is

¹ In 1793, agents of the United States in Amsterdam, charged with contracting a public loan, wrote as follows: "In vain did we strive to stipulate a right for the United States to re-imburse the principal or part of it at their pleasure. The condition was positively and absolutely objected to." In this case the bonds did not have a fluctuating price.

to say that he was ignorant of the true meaning of the contracts which he created. On the other hand, it is known that Mr. Gallatin held strenuously to the policy of debt payment, and with his administration, as we have seen, debt paper began to be fashioned after a new model.

With the law of February 25, 1862, a new clause was introduced into the contracts of public debts. It was stipulated that the bonds created upon the authority of this act should be "redeemable at the pleasure of the United States after five years, and payable twenty years from the date" of their issue. It seems appropriate to give the name of limited-option debts to contracts of this sort, for there is a limited period during which payment of the principal is at the option of the government. France has made some slight use of this form of contract, but for the most part its employment is confined to the United States. It is known in Europe as the American system.

But it is difficult to see what peculiar advantage is found in limited-option debts. The clause which permits the creditor to demand payment at a specified time is no guarantee against the establishment of a perpetual debt, for one legislature can not bind a subsequent legislature to continue a policy of debt payment that it may have begun. A law may provide that a specific debt shall be taken up at a specified time, but since provision for this may be made by the sale of new securities, such a provision can not be effective for extinguishing indebtedness. It may be said that such a clause in the law is educative in its tendencies, but, when one considers how common are long-time contracts in the course of ordinary business, and how familiar is the practice of paying one debt with the proceeds of another, this argument must be regarded as a little fanciful.

But not only is this clause, introduced into the contracts of indebtedness of the United States by Mr. Chase, useless, it may prove the occasion of embarrassment to the administration. Suppose the country to be in the midst of a trying war when the debt falls due, what effect will maturing obli-

gations be likely to exert upon public credit? Will not the necessity of placing redemption bonds, in addition to bonds sold for making headway against extraordinary expenditure, tend to complicate treasury affairs and depress public credit? The expense of the operation also is against it, and this may easily be avoided by making the bonds payable at the pleasure of the government. The United States has thus far escaped any embarrassment from the free use made of limited-option bonds, but this is due rather to her good fortune than to the foresight of her financiers. A good financier will always make the best possible provision for the worst possible contingencies; and this he can not do unless he keeps a debt well under the control of the government.

It remains yet to consider debts payable by installments. The act of November 10, 1803, upon the authority of which stock was issued for the purchase of Louisiana, provides an illustration of such a debt. In this case, there was no option whatever granted the government, the principal being made payable in four equal annual installments. When some special and limited demand for money arises in the course of peace administration, especially if it be of the nature of an investment of funds, there is no objection to contracts of this sort. The supposed advantages arising from them is, that treasury operations are thus kept distinct, and impress themselves upon the administration as separate and independent transactions. It is thus observed that debts payable by installments spring from a desire to establish good budgetary management, but that nothing can be said in their favor as a means of carrying on the fiscal operation of a great war. Indeed, their very conception is out of harmony with an extended system of financing, while the arguments that lie against them are the same as those above urged against limited-option debts.

But there is another method of applying this idea that may not be so easily passed over. It sometimes occurs that the contract which creates a debt creates also the means of its extinction, by demanding an annual payment more than sufficient to cover the interest. Thus it is quite common for

Egyptian obligations to demand that the principal shall be redeemed in a stated number of years (fifteen being the usual time) by an accumulating sinking-fund. The expungement of the debt begins immediately upon the sale of the bonds. So far as the debtor is concerned, there is but one defense for such a contract. On condition that the proceeds of the loan have been invested in some productive enterprise, which immediately brings a revenue into the public treasury, it is but the application of sound commercial rules to throw the burden of the debt upon the earnings of the industry, and to extinguish the claims against it as quickly as possible. But if the investment must lie some time before bearing revenue, as in case of a railroad or a canal, or if the money be borrowed for unproductive purposes, it is contrary to any principles upon which loans may be defended that payment should begin as soon as the contract is signed. Loans are for the convenience of the public treasury, and, unless made payable at the pleasure of the government, may become the source of unnecessary embarrassment. This policy also leads to the absurdity of paying debt while the treasury is under the necessity of borrowing fresh capital, which, to say the least, is an expensive amusement. The criticism upon such contracts as we are here considering is that they join two things that should be kept entirely distinct, namely: debt creation and debt extinction.

Why, then, it may be asked, have English money-lenders chosen to throw the Egyptian debt into this form? The answer is simple. Although unfavorable to debtors, it is of advantage to creditors when lending to weak and unstable states. The carelessness evinced by creditors as to the length of time that bonds may run springs from the fact that a state is conceived as a personage of perpetual life; yet in case of countries like Egypt, capitalists do not like to calculate upon too distant a future. It has been already shown¹ that the value of Egyptian bonds depends in large measure

¹ Part I, chapter ii.

upon the foreign policy of England, and, in the presence of Continental complications, this is a thing that men do not feel that they can safely forecast. It, seems, then, that contracts of this sort may be accepted as evidence either of weakness on the part of the debtor or of distrust on the part of the creditor.

Again, a government may enter into a contract by which it is prohibited from paying its obligations more rapidly than at a fixed annual rate. In this case payment by installments can not be demanded by the creditor, but redemption in any other manner is forbidden the debtor. The most interesting example of such obligations for American readers is that of stock authorized in 1790 for the redemption of the Revolutionary debt. This stock is described in the law as "bearing an interest of six per cent per annum, payable quarter-yearly, and subject to redemption by payments not exceeding in one year, on account of both principal and interest, the proportion of eight dollars upon each hundred." The government could begin this payment at pleasure, suspend it at will, or pay less than two dollars annually toward the extinction of the debt; but there remained no way of hastening payment except by purchase upon the market. The object of this provision was to guarantee creditors in the enjoyment of that rate of interest which ruled at the time the contract was drawn;¹ its practical result was to establish a twenty-four-year annuity of \$8 for every \$100 originally borrowed.

In our previous study of annuities it was discovered that long-time annuities did not meet the requirements of good financing, because they unnecessarily embarrassed the policy of debt payment. The same objection attaches to this plan of Mr. Hamilton. The record of subsequent treasury operations renders it reasonably certain that a simple six-per-cent bond, guaranteed to run for twenty years, would

¹ This was one of the main inducements offered by Mr. Hamilton to obtain subscribers to his loan. In his famous report on public credit, it was assumed that "the rate of interest of money in the United States will, in five years, fall to five per cent, and in twenty to four."

have proved satisfactory to public creditors, and have induced them to comply with the other conditions which the government imposed. This would have brought the larger part of the six-per-cent bonds under the control of Congress in the years 1811 and 1813,¹ and permitted either their redemption or their conversion into stock bearing a reduced rate of interest. But since the right of redemption, except at a stated rate, had been signed away, it was found necessary to continue the higher rate of interest upon the common stock till 1818, and upon the "deferred stock" until 1824.² As the matter turned out, the war of 1812 would have rendered such an operation upon the common stock impossible, had it been permitted by the contract; but this does not excuse the Federalists for having adopted a bad theory of funding.

It has been further urged against payment by installments that they encourage a spirit of careless expenditure among the people—a result due to the small amounts in which the payments come. Referring again to the debt already considered, it was provided by the act of 1796 that the six-per-cent stock should be redeemed by dividends of 1½ per cent in March, June, and September, and of 3½ per cent in December. Upon a thousand-dollar bond this would amount to three payments of \$15 and one payment of \$85 each year, one quarter of which should be accredited to the repayment of the principal. But, since it is difficult to find investments for small amounts, it is quite likely that the entire sum would be spent in current expenses, and, at the end of the twenty-two years required for extinguishing the debt, the creditor would find his principal to have been consumed. Such is the argument, but I can not fully appreciate the importance that is attached to it. It appears

¹ Of this stock there was issued \$80,088,897, of which \$14,177,450 was issued in 1791, and \$12,112,586 in 1793. More than half of the remainder was issued in 1794.

² This was a six-per-cent stock, upon which payment of any interest was deferred until 1800. Its amount was one third of the common six-per-cent.

to me to confound personal saving with the building of a national capital. But, without considering the economic doctrine upon which the argument rests, it is pertinent to notice that investors do not seem to recognize the advantages of repayments in large sums. By a law of February 11, 1807, a refunding scheme was set on foot which tested the point at issue. The law authorized an exchange of the eight-percent annuity bonds for six-per-cent ordinary bonds payable at the pleasure of the government. The main inducement upon which Mr. Gallatin relied to secure the acceptance of his proposal was the fact that creditors when paid would be paid in sums large enough for re-investments. Out of \$31,800,000 of stock to which this law applied, \$8,154,000 only were sent in for exchange into the new stock, thus showing that the public did not appreciate the Secretary's offer. It may be doubted if the thought of what men will do with their money after the government has paid it to them should materially influence a financial policy.

IV. Shall loans be placed at or below par?

We have learned from the foregoing study how necessary it is for the element of time in a debt contract to be fixed by the public authorities; and we now proceed to consider whether it is of greater relative importance for the government to determine the principal of the debt or the rate of interest. There is another, and perhaps a more suggestive, statement of the question, namely: Shall loans be placed at or below par?

We must divest our minds at the outset of the common error that it is possible for a government to decide upon all the conditions under which bonds are issued. Not only is this impossible, but to endeavor to do so is evidence of obstinacy and ignorance rather than of a strong financial policy for which it is so frequently taken. It is a just criticism upon the administration of Mr. Chase that he did not adequately recognize his dependence upon ordinary business motives. In March, 1861, a call was made for the remnant of a loan that was authorized the February previous, and,

although the government was in pressing need of money, Mr. Chase refused all bids below ninety-four cents. This, says Dr. von Hock, an Austrian writer of international reputation, was the first of those errors committed by the Secretary.¹ A further illustration of the false ideas entertained by Mr. Chase, as the representative of a state borrowing money, is presented in connection with the banking loans of 1862. These were two loans of \$50,000,000 each, which certain bankers undertook to place for the government. They were regarded as quite advantageous to the government, but there exists some difference of opinion as to the motives employed by the Secretary to induce the banks to accede to his terms. His biographer and eulogist praises his firmness in defending the interests of the public throughout this transaction. On the other hand, the Austrian writer above referred to says the banks were "half persuaded and half coerced" to accept the terms offered. The general impression is that Mr. Chase threatened to return to Washington and issue treasury notes unless the banks furnished him in gold with what he wanted. Such a suggestion would not for a moment have been entertained by an able financier. A threat under such circumstances shows weakness, and any temporary gain would be more than balanced by entailing loss of credit. A strong financial policy contemplates more than temporary emergencies, and guards public credit with such jealous care that lenders will freely accede to terms advantageous to the government. It recognizes that, in borrowing money, the state, like a private corporation, is subject to the ordinary rules of the market.

Another thought is suggested in this connection. If subscribers to loans be permitted to bid for bonds, it must occur that the financier will receive a great variety of offers. The question then arises whether the government should grant to every subscriber the same terms as those secured by the most favored, or whether each proposal should be taken on

¹ "Die Finanzen und Finanzgeschichte der Vereinigten Staaten von Amerika," von Dr. Carl Freiherrn von Hock, p. 441.

its own merits? Mr. Gallatin was never willing to make discriminations between subscribers of the same class. If, for example, he found it necessary to borrow \$2,000,000, and received bids varying from par to 7 per cent discount, the entire loan would be placed at 93 cents. One who appreciates Mr. Gallatin's character, and knows how delicate was his sense of common fairness, can well understand why he adopted this method in the placement of bonds; but for most people this appears a refinement of justice to which business methods do not usually conform. And, indeed, when it is recognized that lenders are variously situated with regard to disposable capital, that money does not always bear the same value to every man, and that one subscriber may stand in greater need of public stock than another, it is by no means certain that perfect fairness between purchasers is secured by this method. The only financial defense for advertising to equalize bids, lies in the suggestion that the amount which a government must pay for its capital will be less when treating its creditors in a body than when accepting or rejecting each offer by itself. Each subscriber is promised the most favorable terms that must be granted to any subscriber whose capital is necessary to fill the loan. There is, therefore, an inducement offered for men to bid a high price, calculating somewhat upon securing the stock at a lower figure. They bid high because they wish to be among those who secure the stock. On the other hand, if it were known that every subscription remained as first made, the lenders would calculate upon the lowest price that might be offered and still be included in the loan. This question must be decided upon a general knowledge of the motives that actuate business men, for, so far as I am aware, there has been no attempt to place a loan under the stipulations here considered which tests its merits in a satisfactory manner. The general practice of peoples has been against it.

Returning, then, to the original question: Do sound rules of finance demand that the principal of the debt or the rate of interest should be determined by the government? As

a matter of fact, public financiers have quite uniformly regarded the rate of interest as of more relative importance. This was the case with Mr. Pitt, who may be said to have invented discount financing. Mr. Chase also inclined to this opinion, as may be learned from the following quotation from his second report:

The Secretary forbears making any recommendations concerning the authorities with which it may be expedient to invest him in respect to future loans. He begs leave to refer this matter to the better judgment of Congress, suggesting only that, whatever discretion it may be thought prudent to give in other respects, the rate of interest be limited by law.

This manifest leaning toward low rates of interest is in large measure political rather than financial, and springs from the instinct of self-preservation on the part of an administration. The public feels a certain satisfaction in knowing that its government pays 3 per cent rather than 6 per cent upon money borrowed. It may be that the principal in the former case is twice as large as in the latter, so that the burden of the debt is the same, but all people do not analyze with care what party orators may be pleased to tell them. Familiarity with commercial transactions has left the general impression that a low rate of interest is evidence of financial strength, and the government desires to derive what assistance it can from this sentiment.

One can not, however, think this the chief reason why financiers estimate a low rate of interest of such importance that they are willing to suffer heavy discount on the bonds sold in order to secure it. The claim upon which they rest their decision is, that, for a specified sum appropriated to the support of loans, a larger amount of actual cash may be covered into the treasury by means of discount bonds bearing a low rate of interest, than by means of bonds sold at par bearing a nominally higher rate. For purpose of illustration, let it be assumed that the condition of the money market is such that a five-per-cent bond will float at par; by arithmetic computation, a four-per-cent bond ought to sell for 80, and a

three-per-cent for 60. But the fact is that the actual bids for bonds never conform to their relative arithmetic values. If a five-per-cent sells for 100, a four-per-cent of the same sort will sell for more than 80, and a three-per-cent at a figure that is yet relatively higher. There can be no question as to the truth of this statement, as may be learned from the quotations of public stock in any country that has developed commercial ideas. The loans issued by France, for example, on account of the Russian war in 1854, were put out at two rates of interest. It was found that the three-per-cent rentes sold for 65, showing that capital was secured for an actual rate of .0462; the other bonds, paying $4\frac{1}{2}$ per cent, sold for 92, which called for an actual interest payment of .0489. In July, 1806, quotations of American stock were as follows: three-percents, 64; common six-percents, 98; navy sixes, 100; eight-percents, from 105 to 106. Comparing the three-percents with the eight-percents, there is found to be an actual difference in the true interest paid of more than $2\frac{1}{2}$ per cent. This, however, is excessive, and due to particular and not general causes. A comparison of the three-per-cent with the six-per-cent stock shows much more accurately the proper relation between the two sorts of bonds. It must, therefore, be recognized that a government covers more cash into its treasury for a given interest payment when it offers bonds for sale that may be purchased at discount than when the nominal interest is so high that obligations will float at par; and, since it is usual to borrow money only in the presence of some urgent necessity, this saving in the interest account, by which current expenses are somewhat lessened, is regarded as a matter of much moment.

It seems, then, upon the face of the matter, that financiers have sufficient ground for their choice; but, before this may be finally conceded, we must learn why those who lend money are willing to pay relatively higher prices for bonds at discount than for bonds at par. One step in this explanation was suggested in our previous discussion respecting the time for which bonds should be guaranteed against redemption.

Investors always prefer bonds of long life, and they know that a government will not so readily press a policy of debt payment when public obligations stand below par as when they are quoted at par or at premium. This is one reason why discount bonds bear a relatively higher price. But, in addition to this, such bonds secure to the investor two sources of profit, whereas a bond sold at par grants but one. They both pay annuities as long as they exist, but discount bonds alone offer a premium to him who furnishes the government with capital. This premium makes its appearance when paper purchased at discount is redeemed at par; or, for the original investor, it is secured when sale of obligations is effected at a figure higher than the original price. In this is discovered the essential advantage to investors of discount bonds.

This subject will appear in a clearer light if we consider certain other methods of granting special privileges to induce men to place their capital at the disposal of the state. Previous to 1780 most loans were placed at or near par, and the rate of interest paid was not excessive—at least, so it appeared upon the face of the returns. But a closer analysis shows that then, as now, financiers were disinclined to advertise the rates of interest they were obliged to pay. It was the prevalent custom to distribute premiums and prizes to those who would lend money to the government at such terms as it dictated. Sometimes a definite amount of extra stock was issued in proportion to the amount of common stock purchased. For example, \$15 of premium stock, or an annuity terminable at a specified time, would be given to every person who purchased \$100 of stock at par. Sometimes these premiums were distributed in large sums by lottery drawings. In such a case the government availed itself of the spirit of gambling, and the hope of winning a prize through a venture that could not entail total loss of investment, enabled the government to secure money upon more advantageous terms than by a simple distribution of premium stock. Another variation of this bounty system resulted in

a combination of a public loan and a life lottery, or, more respectfully designated, took the form of tontine loans. A tontine loan is one in which the government holds out the hope of excessive returns by application of the principle of survivorship. Suppose that a hundred persons of nearly equal age subscribe to a loan in the form of a life annuity, but that the government is not freed from any payment arising out of the loan until the decease of the last survivor—such an operation would constitute a tontine. The prize in this case is secured only to those who are so fortunate as to survive the other members of the class. Such persons receive the interest upon the total sum subscribed by the class, which insures to the last survivor a large return on the basis of a small investment. There occurred in France not long ago the death of a woman at the age of ninety-six, who had subscribed six hundred livres in two tontines; and, being the last survivor in each class, she received during the latter years of her life an annual payment of 76,000 livres. One may rest assured that her friends procured for her the best possible medical attendance.

Is it not, then, proper to say that the idea of granting special inducements to money lenders, in addition to those clearly stated in the debt contract, may claim whatever respectability arises from age and long practice? And is not one warranted in concluding that the full extent of Mr. Pitt's originality, when he began to sell bonds at discount, was in discovering a new method of applying an old custom? Granting the necessity of seducing money lenders, and of deceiving the public by befogging treasury accounts, there can be no question but that the practice instituted by Mr. Pitt is in every way superior to the granting of lottery prizes or life-chances. Without undertaking a discussion of tontine loans, it may be remarked that they have always proved to be unnecessarily expensive, and have for that reason been quite generally abandoned. The rule of life-chances employed in insurance, and upon which a system of life annuities might be successfully based, does not apply when joined to

the principle of granting a benefit to survivors, for in this latter case the government is obliged to calculate its payments upon the expectation of the life of a class, instead of individuals. The government can not, therefore, balance the falling in of annuities by failure to attain the average age against the unusual payments to those whose lives exceed the common expectation. The lives of all persons in the class must be reckoned as the life of the person who lives the longest. An exhaustive study of tontines would show that the principle upon which they are based is altogether false, whether applied to the insurance of life or to public loans. There is no fairness, no morality, and, in consequence, no public economy in the manner in which they distribute their benefits.

Nor can the system of awarding lottery prizes, whether of stock or money or lands, meet with the approval of finance. Without referring to the spirit of gambling fostered by it, this system is one that quickly exhausts all its resources, and is likely to fail the state when most the state needs assistance. Under certain conditions, and at comparatively long intervals of time, a government may receive assistance from lottery loans; but, if public necessities are of such a nature as to call for continuous appeal to the money-market, it will be found that public credit must, in the long run, suffer from any departure from simple commercial methods.

The issue of premium stock is not open to such severe censure as the use of tontines and lottery prizes, for it is at least possible to reduce the motives upon which such a transaction rests to reliable rules; and, if the premium stock is of the same sort as the ordinary stock, there is no essential difference between this practice and the issue of discount bonds. But if, as was customary, the stock issued for payment of premiums is drawn as a terminable annuity, or in the form of bonds which become operative at some specified time, or payable under special stipulations, our preference must be given to discount financing. The use of such

premiums not only complicates treasury accounts, but it incurs the danger of throwing burdens on the treasury at a time when they might occasion great inconvenience. This may be obviated by the use of discount bonds, and the government may at the same time reap whatever advantage comes with premiums. In this case the premium consists of a promise to purchase at par what was originally sold at discount, but, if the payment of the debt is at the pleasure of the government, so also is that of the premium; the purchase, therefore, need never be made. During the great Napoleonic wars, there were received into the English treasury on account of loans the sum of £498,700,000, for which there were created bonds to the amount of £773,700,000; that is to say, bounties to the extent of £275,000,000 of fictitious stock were granted to those who loaned money to the government. But England has never paid these bounties, for she has never paid her debt. Still the lender has no ground of complaint, for the government has in every particular met its contract, and he has received the benefit of discount purchases through the gradual rise in the price of public stocks.

It must, then, be admitted that, if special inducements are to be granted to purchasers of public obligations, in addition to those clearly expressed in the simple form of a debt contract, the most feasible method of attaining this end is through the sale of discount bonds. But the question yet remains, whether the benefits secured are equivalent to the evils entailed.

One strong argument against discount bonds is, that they lend their influence to the establishment of a perpetual debt. The simple fact that the stock created is nominally greater than the capital originally received, and that the nominal interest paid is lower than that secured upon capital engaged in business, renders people disinclined to tax themselves for the expungement of a debt. There is an economic error in this reasoning, as will be shown when our attention shall be drawn to the topic of debt payment; but, erroneous though

it be, when taken in connection with the disinclination of strong governments to repudiate their obligations, it is sufficient to induce people to transmit to the future all burdens received from the past. "This is the principal cause," says M. Leroy-Beaulieu, "for the duration of public debts in Europe." Mr. Gallatin also regarded discount bonds as a barrier against payment. In his report of 1806 he asked for authority to make certain changes in the three-per-cent stock, "which, he said, in its present shape, may be regarded as irredeemable." This stock was then quoted at 64. It is true that the United States has twice paid off a debt contracted below par, and is expunging the principal of a third, established by a reckless course of financing, but the experience of this nation is by no means final against the claim that discount sales tend to establish perpetual burdens. The payment of public debt in this country is in part chargeable to the industrial vigor and expanding wealth of its inhabitants, but more especially to the fact that her people believe a protective tariff to be the source of private wealth. It would not be safe for the American people to continue their experiments with discount bonds, relying upon boundless resources and erroneous economic doctrines again to pull them through.

But it may be objected that this argument against discount bonds is only pertinent upon the assumption that the principal of debts should be paid. This is true, but it is not, therefore, necessary to accept the converse of the statement, that discount bonds are defensible for a government that has deliberately adopted the policy of perpetual obligations. Assuming even that debts are not to be paid, discount bonds are yet contrary to sound rules of finance, for they do not permit a government, by taking advantage of a fall in the rate of interest, to lighten the annual payment on account of a debt. What was said against the use of annuities applies in large degree to discount bonds. Suppose, for example, that a five-per-cent bond would float at par, but that the government chooses to place a three-per-cent at discount;

in this manner it may effect an immediate saving, estimated on the capital actually received, of one half of one per cent. That is to say, by selling a three-per-cent bond at 66 $\frac{2}{3}$ rather than a five-per-cent bond at par, it pays but 4 $\frac{1}{2}$ per cent interest upon the money covered into the treasury. Holding, then, in mind that the actual rate of interest is 4 $\frac{1}{2}$ per cent, although the nominal rate is 3 per cent, is it not plain that the government can not avail itself of a fall in the market value of money to change the condition of the contract until the market rate for money falls below 3 per cent? The government might be able to secure all the money it wanted at 4 per cent, but it must continue to pay the higher actual rate of interest notwithstanding. Had the bonds, on the other hand, been charged with 5 per cent and sold at par, any fall in market quotations, however slight, would have permitted the government to borrow fresh money, at less expense, with which to extinguish the old debt. There remains, then, a conclusive argument against discount bonds, even though the policy of perpetual debts has been adopted. This argument is, that the immediate saving in interest, secured by the use of discount bonds, is more than balanced by the ultimate loss resulting from the unnecessarily high rates of interest which must be continued, although the credit of the government would permit fresh money to be borrowed at lower rates. It is a safe rule for the financier to hold public bonds closely to par.

The conclusions arrived at from the foregoing analysis may be shortly stated as follows:

Patriotic loans, while they may be sometimes used, can not form a permanent part of a revenue system; forced loans are to be deprecated under all circumstances; voluntary loans appeal to the only reliable motive upon which to rest a credit policy.

With regard to technical questions in the placement of a debt, it was learned that floating debts should be but sparingly used; that credit is strengthened by a guarded variety of debt-paper; that bonds are preferable to annuities; that

government should insist in determining all questions pertaining to time of payment, but that its decisions in this matter should conform to the peculiar conditions of each case; and that loans should be placed at par rather than discount.

CHAPTER III.

LIQUIDATION OF WAR ACCOUNTS.

We shall consider in the present chapter the management of a public treasury at the close of a severe and protracted war. It is not at all strained to introduce this question in a study upon public debts. As modern wars are carried on, the labor of large numbers of men is necessarily diverted from ordinary pursuits, capital is recklessly destroyed, and many economic forces are introduced wholly at variance with the customary industrial relations. It is desirable, for many reasons, that the old industrial conditions should be speedily re-established, and, as it was in large measure through the operations of the treasury department that the country was thrown off its peace footing, so a proper employment of the fiscal machinery may assist in restoring the old conditions.

The first step toward the restoration of peace relations consists in the funding of floating obligations. It is no occasion for surprise that public accounts should become involved during the continuance of a protracted war. Where thousands of men, subject to the accidents and exigencies of war, are dependent for support upon a single agency, there can not be perfect control in matters of purchase and supply. An army is frequently obliged to live off the country through which it is passing, and to make impressments of all sorts that its onward course may not be checked. Under such conditions the commander takes whatever is needed, and issues certificates of indebtedness for the goods taken. Transactions of the commissary, also, are sure to give rise to

forms of obligations that leave the public accounts at the close of hostilities in a confused condition. This was the case at the close of the late rebellion. In March, 1865, there were outstanding \$171,700,000 of certificates of indebtedness and \$114,200,000 of suspended and unpaid requisitions.¹ Such accounts as these should receive the immediate attention of the financier, because they weigh heavily upon the credit of the government. If existing in the form of un-audited and unsettled claims, they are not regarded as good commercial paper, for they do not carry upon their face evidence of their own genuineness. They are, consequently, unavailable assets to those who hold them. They can not be sold except at discount, nor can they be used as security in the borrowing of money—in short, they partake of the character of unaccepted bills. Thus, the fact that some of the obligations of the government are not settled and funded obstructs their use, narrows their market, and, in consequence, depresses their price below their natural or arithmetic value. This can not fail to influence the price of all government securities.

For another reason, also, will an unadjusted debt become the subject of uncertainty and distrust. Those in possession of such obligations at the close of a war are likely to be "feeble holders"—that is to say, men whose necessities force them to sell their debt for what it will bring. Speculation will spring up about this class of securities, and not only will injustice be done the original holder, but the credit of the government will necessarily suffer. The history of the floating obligations created by the Revolutionary War is a warning to all financiers of the danger that lurks in any neglect of this sort of debts.

A stronger reason, however, is presented in the fact that a floating and uncertain debt is a hindrance to the re-establishment of peace industries. In order to introduce again

¹ Bearing six per cent interest, payable one year from date, or earlier, at the option of the government, issued in satisfaction of audited and settled accounts.—Law of March 1, 1862.

into society that diversity of industries which marks a healthy business adjustment, the task of undertakership must be easy and sure. This task consists in bringing men and material together for productive work. In a highly organized commercial society, the ease with which this may be done depends upon the availability of assets. If men can quickly realize upon whatever property they possess, every business opening in which there is a reasonable hope of profit will find some one who is willing to risk its undertaking; and this is the reason why, from the standpoint of industrial re-adjustment, it becomes the first duty of the financier to rescue all public obligations from doubt and uncertainty, since by so doing they are rendered available for business purposes. In this respect there is nothing to be criticised in the financial management of the United States treasury directly after the close of the late war. The army was promptly paid, and outstanding obligations were thrown into available form, and in this manner the government provided, so far as it lay in its power, for labor to come into contact with capital.

It further lies within the duty of the financier to simplify and unify the funded debt and to ask from the legislature a clear interpretation of any questionable phrases in the laws that define the duties of the treasurer or the right of creditors. In general the reasons for this are the same as have been already presented in favor of the liquidation of uncertain obligations. But there is an additional reason why clearness and certainty should attach to funded obligations. It may be that, at the close of war, the country finds itself in a condition to employ with profit foreign capital, and that this capital may be the most easily procured by an exportation of national obligations. In such a case, it is desirable that the price paid for this debt should be as high as possible, for the higher the price the larger will be the amount of capital returned, and the less will be the premium necessary to pay out when the debt is again brought home. Upon the world's market the power of absorption is so great

that the amount of bonds offered for sale is not the most potent element in determining their value. Provided only the people who sell their promises are believed to be willing and able to meet their obligations, the price which their bonds may command will approximate the capitalization of the interest calculated upon at the ruling rate for money upon the market where the bonds are sold. It must, therefore, be regarded as wise statesmanship to declare a simple, a strong, and an honest policy, and to so interpret the contract that no doubt may exist respecting it, for then only can a people realize the full value of their debt upon exportation.

There is another question pertaining to the management of floating obligations far more difficult of solution than those just passed in review. It is more than probable, in the present state of financial sentiment, that an exhaustive war will occasion an issue of irredeemable paper money, and the question that now presents itself inquires respecting the true policy of a government, if, at the close of hostilities, it find itself in the presence of an inflated circulating medium.

It may be fairly assumed that the people intend sometime to resume payments in specie—at least, our present discussion need not be encumbered with a supposition to the contrary. Should one refuse to admit this assumption, it is suggested that he interrupt for a time his study of public debts, and learn the lesson taught by history respecting the evils that invariably follow all attempts to employ local currency. Admitting, then, the necessity of resumption, the pertinent question for the financier is, whether this shall be undertaken immediately upon a return of peace, or whether it shall be postponed until financial reconstruction in other directions shall have been perfected.

There are several reasons why resumption of specie payments should claim early attention. Thus, as worthy of first notice, a government can not expect to enjoy high credit so long as there is any doubt respecting the kind of money that may be employed in the discharge of its contracts. It is not

enough to declare that bonds are payable in specie, for, so long as a depreciated currency remains the familiar medium of exchange within a country, jealousy of the public creditor will be a constant menace to the fulfillment of such a promise. Familiarity with irredeemable paper is a standing invitation to partial repudiation, and, without considering the justice or morality of such a measure, it is sufficient to say that, in the long run, any scaling of debts is a very expensive measure of lightening taxation. High credit is an essential condition to an early conversion of the debt, and a self-regulating currency, based upon the kind of money used by the important commercial peoples of the world, is essential to high credit. From this it appears that the economy of national resources demands the quickest possible return to a specie basis.¹

Again, recognizing a return to specie payments as an ultimate necessity, there will probably be less resistance to such a measure immediately after the close of hostilities than at any subsequent period. The sentiment of a country is then, on all questions of reconstruction, in a somewhat plastic condition, and may be formulated with comparative ease in favor of radical financial measures. It is of course possible that a people may recede from a policy of resumption upon which they have actually entered, but one can not on this account conclude that the endeavor has been fruitless. Even though for a time the policy be set aside, it leaves within the country a party whose political reputation is bound up with the ultimate success of the measure, and the natural desire in all men to prove that they were in the right when in the minority will keep the question before the public. And more than this is true. When it comes finally to be recognized that healthy industries can not be maintained upon the basis of an inflated currency, and the country begins to feel the enervating effects of a too free use of indus-

¹ This subject is more fully considered in the following chapter which treats of the policy of conversion.

trial stimulant, there lies in the immediate history of the past a rejected policy about which a truer sentiment may easily crystallize. For this reason it seems wise that a *post-bellum* financial policy should embrace a plan for an immediate return to a sound money basis.

The most important argument, however, in support of the policy here proposed, rests upon the well-known workings of an irredeemable paper currency. There is no law of fiscal science more firmly established than this : that an excess of circulating medium depreciates the value of the purchasing unit and leads to unsteadiness of general prices. It is equally well recognized that unsteadiness of prices invites speculation, retards the establishment and extension of healthy business, and, if long continued, must surely lead to the throes of a commercial panic. Against such a calamity the financier should oppose the full influence of the treasury department. He should do all in his power to restore those conditions in which trustworthy calculations are possible, for in this manner it may be he rescues the country from the evils of a commercial revulsion.

It was this argument which induced Secretary McCulloch to advocate in his first report the policy of contraction and resumption. For illustration of the evil workings of superabundant paper, he did not search the history of foreign peoples nor the financial record of his own country for more than thirty years ; yet the facts which he recited are adequate for the complete vindication of the plan which he submitted to Congress. It would be well worth the time of one who desires to fully understand this subject to read with care the financial report of 1865. The Secretary there traces the inflation of banking paper and discounts which preceded the commercial crises of 1837 and 1857, and compares the greater inflation of 1865 with the condition of affairs thus disclosed. Like causes, he argues, will naturally produce like results.

Upon the last of October, 1865, the circulating medium of the country was substantially as follows :

1. United States notes and fractional currency.....	\$454,218,038.20
2. Notes of the National banks.....	185,000,000.00
3. Notes of the banks, including outstanding issues of State banks converted into National banks..	65,000,000.00
	<hr/>
	\$704,218,038.20

In addition to the United States notes, there were also outstanding \$32,536,900 five-per-cent treasury notes, and \$173,012,140 compound-interest notes, of which it was estimated that \$30,000,000 were in circulation as currency. It thus appears that the paper money of the country amounted to \$734,218,000 without including any of the 7.30 notes, some of which were in common circulation. As contrasted with this, the bank notes in circulation in January, 1860, were put at \$207,324,000. "Nothing beyond this statement," concludes the Secretary, "is required to exhibit the present inflation or to explain the causes of the current and advancing prices. If disaster followed the expansion of 1837 and 1857, what must be the consequences of the present expansion unless speedily checked and reduced."¹

The argument presented by Mr. McCulloch in favor of an immediate return to specie payments is neither brilliant nor new, but it possesses the rare merit of being true. The root of all opposition to the policy which he so strenuously urged is found in the fear that the change from a paper to

¹ The banking circulation for selected years previous to the war, as also the deposits and loans of the banks, are given in the following table. The significance of these figures consists in the marked expansion of credits that preceded the commercial disasters of 1837 and 1857.

YEAR.	Notes.	Deposits.	Loans.
January, 1830.....	\$61,324,000	\$55,560,000	\$200,451,000
" 1835.....	108,692,495	88,081,000	865,168,000
" 1836.....	140,301,088	115,104,000	457,506,000
" 1837.....	149,186,890	127,397,000	525,115,000
" 1843.....	58,564,000	56,168,000	254,544,000
" 1856.....	195,747,950	212,706,000	634,183,000
" 1857.....	214,778,822	230,351,000	684,456,000
" 1858.....	155,208,344	185,932,000	583,165,000
" 1860.....	207,102,000	253,802,000	691,945,000

a specie basis will discourage business enterprises. The first step toward the use of superior money is to get rid of so much of the inferior money that the two together will not constitute redundant currency; but such a step must entail a sacrifice of part of the price of all commodities affected by the excessive issues. Thus the policy of contraction means a falling market, and this brings with it a state of affairs in which long contracts are dangerous, and jobbers are in consequence afraid to carry large stocks of goods, or manufacturers to work to the full capacity of their machinery. Under such conditions business imagination is damped, or, to state the matter in common language, contraction brings dull times. For such as, on account of the evils here set forth, urge the permanent maintenance of "domestic currency," the following argument can have no pertinency, since the only point now conceived to lie in question has to do with the proper time for setting on foot a policy recognized as ultimately necessary. On this question there is room for honest and reasonable difference of opinion. Those who oppose the claim that a resumption of specie payments should engage the first attention of the government after cessation of hostilities, do so because they conceive that a people must be in an exhausted condition at the close of a war; and, feeling that a restitution of industries to a peace demand is of prime necessity, they wish to postpone the burden of contracting the currency to a more convenient season. The plan recommended by them would be to first reconstruct industrial society upon the basis of an inflated currency, to recall labor discharged from the direct service of the state to its accustomed channel of activity, and then to administer the medicine of contraction which a radically pernicious system of financing during the war has rendered necessary.

This position assumed by the opponents to quick resumption may be met in two ways. It may be urged that the evils attending a process of contraction are of slight importance; but to adopt such language is to confess one's ignorance of the confusion and discouragement that arise from rapidly fall-

ing prices. As Mr. Mill truly says: "It [money] only exerts a distinct and independent influence of its own when it gets out of order," but when out of order its workings are in the highest degree pernicious. The more rational reply to those who would postpone all measures looking toward resumption is, that postponement aggravates the evils of which complaint is made, while immediate curtailment in the amount of money will shield the country from the full effect of an inflated currency. If this claim can be made good, there remains no room for doubt as to the expediency of quick resumption.

An analysis of the claim here presented leads to a consideration of general prices from three points of view: We must, in the first place, look at the influence of a return of peace upon general prices, and through prices upon the spirit of venture indulged by business men; we must, in the second place, notice the different results that follow the various ways in which a redundant paper currency may be used; and, lastly, we must discover the order in which the several classes of commodities are affected by the process of inflation. It is only upon the basis of facts disclosed by such a study that we may reasonably determine the time at which a policy of contraction will entail the least sacrifice upon a country. Let us, then, consider these questions in the order in which they have been suggested.

Firstly.—The immediate commercial effect of a return of peace, after a contracted war, is toward an advance of general prices. This will follow irrespective of the sort of money the country is using. It finds its source in the feeling of hope that permeates society on account of changed commercial conditions. But this tendency can not be regarded as permanent; indeed, from its very nature, it is not able long to endure. It is known that a return of peace will reopen the channels of normal demand, and it is believed that they who first present themselves to the consuming public with an adequate supply will reap large reward. Since, however, every producer is secretly entertaining this intention, industrial society becomes abnormally active. An increased demand

for raw material is thus created, which tends to raise its price ; labor, also, may be in some slight degree affected, and in general the phenomena of a rising market make their appearance.

Now, it must be recognized that this state of affairs rests upon hopes which can not be fully realized.¹ It springs in part from an exaggerated estimation of the extent of a peace demand in time of peace as compared with peace demand in time of war, and in part from the determination of each producer to come first into the market with goods for sale. But such miscalculations and such competition lead directly to commercial disaster. The government can do much to allay this spirit of unwarranted speculation by announcing its determination to proceed at once, and in the most direct manner, to the re-instatement of specie currency. There will undoubtedly be protests from the public. The cry against such a policy will be raised by those who expect to reap personal advantage from rapid fluctuations in general values, as also by those who, not discerning the true cause of threatened evils, hope to avoid all commercial embarrassment by maintaining currency at its inflated amount. The purpose of the former class is dishonest; that of the latter class is impossible of realization. The true policy is to reduce the volume of money in circulation, for contraction firmly established and actually entered upon would do much to clear the imagina-

¹ "There are no indications of real and permanent prosperity in our large importations of foreign fabrics; in the heavy operations at our commercial marts; in the splendid fortunes reported to be made by skillful manipulations at the gold-room or the stock board; no evidences of increasing wealth in the facts that railroads and steamboats are crowded with passengers, and hotels with guests; that cities are full to overflowing, and rents and the prices of the necessities of life, as well as luxuries, are daily advancing. All these things prove rather that a foreign debt is being created, that the number of non-producers is increasing, and that productive industry is being diminished. There is no fact more manifest than that the plethora of paper money is not only undermining the morals of the people by encouraging waste and extravagance, but is striking at the root of our material prosperity by diminishing labor. *The evil is not at present beyond the control of legislation, but it is daily increasing, and, if not speedily checked, will at no distant day culminate in widespread disaster.*"—"Report of Secretary McCulloch for 1865," p. 9.

tions of business men, and to prevent the evil consequences which would follow the restoration of peace industries upon a plane of prices abnormally high. This benefit is, of course, not comparable with the sacrifices of extended contraction, but the argument assumes that contraction is inevitable, and recommends that it be undertaken when incidental benefits may attend the measure.

Secondly.—But it must also be noticed that failure to reduce the volume of money in circulation at the close of a war that has been carried on by means of legal-tender notes amounts, for all practical purposes, to a still further expansion of the currency. This arises from the changed use to which the currency is put, and relies for an explanation upon the fact that general prices are more sensitive to fluctuation in the volume of money when the exchanges affected by it are numerous rather than large. Such a change, in a country whose military policy is like that of the United States, always attends a return of peace, because cessation of hostilities permits an immediate reduction of both army and navy expenditures. For example, in the case of the late war, within four days after the surrender of General Lee, all enlistments and all purchases for the army were discontinued. On the 1st of April, 1865, there were a million men in the field under pay from the government; at the end of October, eight hundred thousand had been discharged from the public service, and by 1866 the standing army had been reduced to fifty thousand men. By this means the public expenditure for the support of the army had been reduced from \$518,200,000 to \$33,800,000. Curtailment in the navy was nearly as rapid. During the last two years of the war the government had consumed nearly twenty-seven per cent of the total product of the nation, and the treasury notes which it issued were in large measure used in purchases on a grand scale. Upon the disbanding of the army, however, this unusual employment of notes passed away, while the return of peace demand, calling for a re-adjustment of industrial energy, drew the greater part of existing money into the ordinary

channels of trade. In this manner the prices of many commodities, which had been before affected as it were by sympathy, felt for the first time the direct and full influence of a redundant currency.

The reasoning which leads to this conclusion rests upon the fact that a larger proportion of the redundant currency is forced into retail trade in time of peace than in time of war. "The principle of limitation," says Mr. Tooke, "to the maintenance of an advanced price of any particular article, . . . is not the quantity of money in existence in the country, but the quantity of money in the hands or pockets of consumers destined for expenditure in that article."¹ This is pertinent to the point in hand when placed by the side of the following distinction submitted upon the authority of Adam Smith: "The circulation of every country may be considered as divided into two different branches—the circulation of the dealers with one another and the circulation between the dealers and the consumers. . . . The value of the goods circulated between the different dealers with one another never can exceed the value of those circulated between the dealers and the consumers, whatever is bought by the dealers being ultimately destined to be sold to the consumers. . . . [But] paper money may be so regulated as either to confine itself very much to the circulation between the different dealers, or to extend itself likewise to a great part of that between the dealers and the consumers."²

For the question we are now considering, the point to be decided is, whether the extension of the wholesale trade attendant upon a return of peace will absorb the fund of treasury notes formerly used by the commissary department in making its purchases. Under the established system of credit transactions, it is doubtful if this will be the case; for transactions between dealers are usually carried on by means of the mechanism of banking, which, being in reality a system of refined barter, is cheaper than the cheapest money.

¹ "An Inquiry into the Currency Principle," by Thomas Tooke, Esq., p. 74.

² "Wealth of Nations," McCulloch's edition, pp. 141, 142.

The wholesale trade, therefore, although the volume of its exchanges may increase far beyond the cessation of purchases on the part of the government, can not absorb the money thus set free. It must flow into the channels of retail trade, and be used in purchases between consumers and small dealers—that is to say, if not withdrawn from circulation it must be used in such a manner that the country will suffer to the utmost the pernicious effects of a redundant currency.

Thirdly.—There is another reason why a quick return to a specie basis after the close of a war may shield the country from the full consequences of an erroneous course of financing. Many who write upon the influence of an expanding currency make the mistake of supposing that the volume of money forms a level like that of the sea, and that commodities, like ships floating upon its surface, rise and fall with its ebb and flow; but the truth is that no such constant ratio can be maintained in the list of general prices disturbed by fluctuations in the currency. Those commodities whose prices are the most easily affected are such as may be quickly produced and quickly consumed. The demand for them is constantly recurring, and for this reason they come frequently into contact with the circulating medium through actual sales. On the other hand, goods that last for some time, or that consumers may easily avoid by foregoing their use, or which are not subject to frequent sales, do not so readily reflect variations in the amount of money by changes in their price. We are then prepared to learn that land used for agricultural purposes is the last commodity to be influenced by a redundant currency. Even house rents and city real estate, which respond quickly enough to speculative excitement, move but sluggishly under the stimulus of inflation.

This being the case, it must certainly be to the interest of the country at large to arrest the natural workings of inflation before it has exerted its full influence upon landed property. It was especially appropriate that the United States should hold this in view in 1865, since a large proportion of the men who were discharged from the army turned

their attention to agricultural industry,¹ and it was through their purchases that the redundant currency found its way into the values of farming lands. It is not claimed that any measures which the government might have taken could have wholly avoided this result, for the money was in the hands of those who wished to buy land, and could not be gotten from them in any other way than to give them land for it. But it is claimed that the tendency toward speculation in land, following this fictitious and temporary rise of values, which led to the mortgaging of farms to secure more money with which to buy more land, or to the purchase of so much land that the stock and machinery for working it must be bought by the proceeds of a mortgage, might have been checked by a vigorous and decided policy on the part of the government. This would have obviated much of the suffering that attended contraction. In the manufacturing industry, capital is so quickly turned that the producer can frequently throw part of the loss of falling prices on the consumer, or on the party from whom he buys his raw ma-

¹ "The diversion from the industries of the Northern States, consequent upon the war, is variously estimated at from 500,000 to 750,000 men. It is not to be understood that these figures represent an absolute loss to the industry of the country, although such loss, from casualties and diseases incident to war, was undoubtedly very considerable; but the universal testimony of manufacturers is, that the operatives who entered the army from their establishments have not, as a general thing, returned to their old employments. In two instances where a somewhat careful examination was made by the proprietors of manufacturing establishments in different sections of the country, the following results have been reported to the commissioner. In the first instance, out of 127 men entering the army from an iron establishment in one of the Middle States, only 17 are known to the proprietors to have resumed their former occupations; and in the second instance, out of 16 leaving a manufactory in a New England State, but two individuals are believed to have returned. Of this deficit, some have engaged in the cultivation of cotton, and in various other industrial pursuits in the South; a much larger percentage have sought new homes and new employments at the extreme West, or on the Pacific coast; while others, taking advantage of the capital made available to them through the payment of bounties and previous savings, have become principals rather than subordinates in business, or, in cases of persons of foreign birth, have returned to the countries of their nativities."—"Report of David A. Wells as Special Commissioner of the Revenue for 1866," pp. 21, 22.

terial; his permanent capital bears but a small ratio to the total of his transactions. But the permanent investment of the farmer is always his largest investment, and the industry of agriculture calls for twelve months for the completion of a single process; from which it follows that a farmer who has mortgaged his property on a rising market, must stand the loss of paying the debt while prices are falling. This is the reason why the agricultural interest always stands opposed to a policy of contraction more strongly than either the manufacturing or commercial interest. Such a policy bears more heavily upon farmers who have mortgaged their property than upon those engaged in businesses admitting of greater mobility of action. Assuming, then, that the country must suffer the evils of contraction, it seems wise to undertake this measure when the lands of the country are likely to be the least encumbered, and to proceed in such a manner as to discourage speculation in landed property.

It may serve to strengthen the argument here set forth if we notice the movement in current prices during the continuance of our late war and for a few years after its close, as presented in the table given below. It is believed that the commodities selected are representative of classes, whether one consider the influence of changes in the tariff or the modification in demand occasioned by the return of peace.

Table of prices quoted on the New York market for January of the years named.¹

	1861.	1865.	1868.	1872.	1873.
Flour, per barrel.....	\$6.85	\$16.00	\$10.00	\$6.50	\$4.90
Ashes, per 100 pounds.....	5.00	11.75	8.25	9.00	4.50
Leather, per pound.....	.10 $\frac{1}{2}$	.43	.25 $\frac{1}{2}$	.35	.28
Sugar, per pound .....	.06 $\frac{1}{2}$	.19	.11 $\frac{1}{2}$	.09	.07 $\frac{1}{2}$
Pig-iron, per ton.....	91.00	68.00	86.00	88.00	26.00
Lard, per pound.....	.10 $\frac{1}{2}$	.28	.12 $\frac{1}{2}$	.09 $\frac{1}{2}$	.07 $\frac{1}{2}$
Codfish, per quintal.....	8.50	9.00	5.50	5.00	5.50
Wool (fleece), per pound....	.30	.95	.60	.70	.47

¹ Compiled from price lists in "Hunt's Merchants' Magazine" and "Commercial and Financial Chronicle."

It would be quite erroneous to assume that all the changes in price shown by the above table are due to fluctuations of the currency; indeed, some familiarity with the commercial history of the period covered is necessary to derive from the figures a correct impression. The rise of prices during the war, which a comparison of the first and second columns brings into view, is observed to vary for various articles from 100 to 300 per cent, and may be fairly charged to the policy of treasury management adopted by the government. As Mr. Tooke truly says, "A compulsory government paper, while it is in the course of augmentation, acts directly as an originating cause on prices and income"; and if proof were needed for this observation it might be furnished by the fact that the gold price of commodities, estimated upon the basis of thirty selected articles in the usual manner, was 2·34 per cent lower in 1865 than in 1861.¹ But it is with the year 1865 that the movements in price become for us the most interesting. It is well known that the policy of contraction as the first step toward the resumption of specie payments was advocated by Secretary McCulloch in his first report, and that a law authorizing the retirement of treasury notes was passed in the early part of 1866. It should also be remembered, in seeking to interpret the figures given in the table, that the Southern States had no currency at the close of the rebellion, and that the drain upon the Northern States to supply this deficiency acted like a further contraction of the volume of currency for the North itself.

Let us now compare the prices of the year 1865 with those of 1868 in the light of the facts just mentioned. We observe them to be somewhat lower, notwithstanding that the low gold prices of 1865 permitted a slight normal increase, and that a return of peace demand would naturally engender commercial speculation. This seems to indicate that the law which permitted treasury notes to be retired

¹ Cotton is excluded from this estimate; were cotton included, average prices would show a rise of 6·57. Cf. "Journal of the Statistical Society of London," vol. xxxi, p. 221.

opposed with some success the tendency toward unhealthy expansion of business. But such a result was repugnant to large numbers of men, and there was wide-spread criticism of the Secretary and his policy. This led to the repeal of the law in February, 1868. Prices were consequently thrown open to the full influence of a redundant currency, and the result may be traced by comparing the quotations of 1868 with those of 1872, the year before the panic burst the bubble of prosperity upon which the dominant party congratulated itself so highly. Had the treasury been managed according to sound principles, the prices of 1872 should have been lower than those of 1868, but a glance at the table shows them to have been a trifle higher. The exceptions are wheat, lard, fish, and sugar, all agricultural commodities. And the fall in sugar is partly accounted for by a reduction of the tax, while the fact that the tax on iron was reduced shows the quotations to represent inadequately the tendency toward a rise in that commodity. The figures in the last column of the table, being for the year 1878, may be said to disclose the level of prices upon which it was possible for the country to maintain specie payments.

It is with great hesitation that I am willing to draw important conclusions from commercial quotations. So many complications enter into the determination of prices that one must exercise the greatest care in reading the tendencies which they disclose. But, admitting all that may justly be said in this vein, it seems that the table presents presumptive evidence favorable to the argument for a speedy contraction of the currency when the necessity for forced loans has passed away. The repeal of the act empowering the Secretary of the Treasury to redeem treasury notes threw down the barrier which had been raised against the full effects of inflation. In 1872 the country was no nearer the basis of specie prices than three years after the close of the war. Mortgages meantime had piled up, business had been extended under the influence of an unnatural stimulus, and the country paid the penalty by the panic of 1873.

Passing now from further consideration of the necessity of quickly resuming specie payments, what may be said respecting the most appropriate method of procedure? Three plans have received advocacy from both publicists and statesmen.

The first of these is the plan assumed to be the correct one throughout the foregoing discussion. It demands such a reduction of the amount of money afloat that prices will be brought to a specie basis, for then only can foreign trade be relied upon to bring specie from abroad, or to retain it if mined at home. It thus appears that the maintenance of specie payments is very closely allied to international trade. Indeed, one of the chief arguments favoring the necessity of a return to the basis of gold and silver is that such money, being international money, is self-regulating in amount; and that, in consequence, the country will not be subjected to marked fluctuations in prices from purely domestic causes. A permanent excess of currency is impossible if that currency be such that foreign people will accept it in payment of purchases; for since prices are, on account of the excess, higher at home than abroad, those who hold money will prefer to purchase abroad. But with paper money, clothed with the power of legal tender at home, this is not the case. It is purely local in character. It is because treasury notes are issued in such amounts that all domestic exchanges can be carried on by means of paper money that specie disappears from circulation, and the theory of resumption now before us rests for its defense upon the fact that specie can never again return into circulation until, through the reduction of the number of treasury notes afloat, it is needed for domestic trade. It is for this reason that quick resumption demands arbitrary contraction.

But it may be asked: Why should this reduction of the currency be arbitrary? Why not refuse to increase the amount, and permit the necessities of the country to grow up to its use? This policy was favorably received by Mr. Boutwell, and controlled the decisions of the administration

so long as he remained at the head of the Treasury Department.¹ It is, however, idle to suppose that the evils of contraction may in this manner be avoided. It makes no difference whether the amount of money is brought down to the necessities of trade upon the gold basis, or that trade is permitted to grow up to an arbitrarily established amount of money, the effect upon prices is in either case the same. The real point at issue between these two policies of resumption pertains to the time at which contraction should be set on foot, and the rapidity with which it should proceed. Respecting the appropriate time for beginning, we have already discovered that immediate contraction, undertaken at the close of a war, will shield the country from the full effect of inflation; and the same line of reasoning permits us to conclude that hesitation or weakness in carrying out the policy defeats the purpose for which it was set on foot. It is a case where speedy recovery is sure if the remedy be severe. The evil of contraction can not be avoided by permitting the disease to wear itself out, while, by allowing matters to take their own course, the recovery of healthy business conditions is indefinitely postponed.

A third plan for the resumption of specie payments calls for the accumulation of a specie reserve in the treasury vaults. As a subordinate part of a policy of contraction, this is wholly defensible. It is necessary for the government to be in possession of sufficient cash that all notes presented may be promptly paid. But the accumulation of coin is not of itself an adequate measure, for it leaves out of view the question of prices. However men may desire to avoid it, prices within a country must come down to the world's prices, or the world's money can not be used. Suppose an accumulation of specie equal to the entire amount of outstanding treasury notes, the country might be as far from resumption as when the accumulation began. Any attempt to substitute the specie for the notes would be followed by heavy ex-

¹ Cf. "Report on the Finances," 1872.

portations of bullion, and the country would be obliged to get along with so much as it could retain in trade when its prices had fallen to the level of the prices of other countries. The pressure of falling prices must come, and the only occasion for deliberation is to discover the time at which contraction will cause the least disaster.

It may be interesting in this connection to notice the changes of policy that have attended the steps toward resumption in the United States. The attitude of Secretary McCulloch has been already referred to, and the sentiment of Congress in the latter part of 1865 seems to have been in complete harmony with the views of the Cabinet. But from the report of 1866, it appears that the Secretary did not consider his policy to have been supported by adequate legislation. He says:

The Secretary regrets, notwithstanding the large reduction of the national debt, and the satisfactory condition, in other respects, of the national treasury, that little progress has been made since his last report toward specie payments. The views presented by him in that report, although indorsed in the House of Representatives by a nearly unanimous vote, were not sustained by corresponding legislation. Instead of being authorized to reduce the paper circulation of the country, according to his recommendations, the amount of the United States notes which he was permitted to retire was limited to \$10,000,000 for the six months ending October 12, and to \$4,000,000 per month thereafter.¹ In the mean time, the reduction of these notes, and the notes of the State banks, has been nearly balanced by the increase of the circulation of the National banks, and specie commands about the same premium it did when the last treasury report was prepared.

It seems, then, that such influence as was exerted by the policy of contraction made itself felt through the declaration of the policy rather than by means of actual contraction of the amount of notes afloat. It is probable that the check in the rise of prices, observed immediately after the war, is largely due to the demand for currency in the South and on the Pacific slope.

¹ Law of April 12, 1866, Sec. 1.

The authority of the Secretary to retire treasury notes was "suspended" by an act of February 4, 1868, a measure which did not meet with the approval of the President, and which became a law through his failure to return the bill to Congress within the time prescribed by the Constitution. It would, however, be an error to interpret this as an abandonment of the policy of resumption. Upon March 18, 1869, a law was enacted pledging the United States, in all cases where the wording of the contract admitted of doubt, to payment in coin or its equivalent of all public obligations; and further declaring that treasury notes should be redeemed in specie before the payment of any part of interest-bearing obligations not due at the date of the act, unless some bonds bearing a lower rate of interest than the bonds to be redeemed could be sold at par in coin.

From this time until 1874 the sentiment of the country found expression in the policy set forth by Secretary Boutwell. This statesman proposed to let matters run themselves, in order that the credit of the country might be safe, and exports come to overbalance imports;¹ for then, he claimed,

¹ "The ability of the country to resume specie payments will not be due to any special legislation upon that subject, but to the condition of its industries, and to its financial relations to other countries. These, of course, will be more or less dependent upon the general policy of the government. The war exhausted the country of its material wealth, and the States of the South were literally impoverished. A necessary condition for the resumption of specie payments was the development of the industry of the nation, both South and North, and the consequent accumulation of the movable products of industry to such an extent that exports of those products should be equal substantially to our imports. So long as it is necessary to pay for merchandise imported, by the transfer of government bonds or other evidences of indebtedness to other countries, so long it will be impracticable to resume and maintain specie payments. When the products of industry exported shall be equal substantially to the products of other countries imported, there will be no demand for specie for export, except what may arise from the circumstance that our bonds held abroad are sent home, sold in our markets, and the proceeds exported in coin. When the credit of the country shall be fully established in Europe, and there shall be no doubt either of our ability or disposition to meet all our obligations, bonds heretofore, and now to a large extent, held by merchants and bankers, will be transferred to capitalists for permanent investments. When this change shall have

there would be no danger of bonds being sent home from Europe as the result of a scare, and resumption could take place with no shock to business. "It is probable," said the Secretary, "that some decrease in the volume of paper will ultimately be necessary," and he proposed that Congress should authorize the redemption of notes "not exceeding two millions of dollars in any one month." It was also suggested that the contract upon which the five-twenty bonds were issued should be so changed as to adapt them for permanent investments rather than commercial paper, and that a subsidy should be granted to shipping, and higher protective duties to iron, wool, and cotton, so as to "affect favorably the balance of trade."

The policy of resumption advocated by Secretary Bristow brings to view one point of peculiar interest. He stated it as a fundamental idea that the banks and the people could not prepare for resumption "so long as the large amount of irredeemable paper now in circulation continues to be by law legal tender for all private debts with reference both to the past and the future. While this state of things lasts, gold will continue to flow from us, and find employment where the natural laws of trade, unobstructed by restraining legislation, make its daily use indispensable." It was, therefore, proposed to take from the notes their legal-tender character for all contracts entered into after a specified date, and then, after the lapse of a definite time (three years was regarded as sufficient), to undertake the redemption of notes in specie. It was also advocated that the law should provide for the conversion of notes into interest-bearing bonds, as also for the sale of bonds equal to the entire amount of notes outstanding less available surplus in the treasury.

taken place, the probability of our securities being sent home under the influence of political or financial disturbances in Europe will be very slight; and when, as a concurring fact, our exports, exclusive of public securities, shall be equal to our imports, specie payments may be resumed without even a temporary embarrassment to the business of the country."—"Report of the Finances for 1869," pp. xiii and xiv.

The plan of resumption which comes into comparison with these views is the one embodied in the law of January 14, 1875, according to which the return to specie payments was actually accomplished. This law did not modify in any way the legal-tender quality of such notes as were permitted to remain in circulation, but provided that their excess above \$300,000,000 might be converted into notes of the National banks at a fixed ratio, which notes, it will be remembered, are not a legal tender.¹ This was done by removing the restriction placed upon the issue of bank-notes, and requiring the Secretary of the Treasury to redeem United States notes equal to eighty per cent of the new issues. It thus appears that the general purpose of the Secretary, to reduce the quantity of legal-tender paper below the amount necessary to carry on domestic exchanges, was realized. Yet there is a difference between his plan and that embodied in the law. Had the plan of Secretary Bristow been adopted, the treasury department would have been converted into an ordinary bank of issue; but, by the plan embodied in the law, the government escaped the necessity of issuing notes that circulate merely because they are redeemable in legal money, while at the same time it retained the advantage of furnishing the public with so much of the paper circulation as under no circumstances will be presented for payment in specie. In this manner the law provided for elasticity in the circulating medium, while retaining a considerable portion of the debt in use as money, and for this reason are we constrained to approve the law rather than the plan submitted by the Secretary.

For the rest, the provisions of the law were very simple. Free coinage of gold was established in place of a charge of one fifth of one per cent. The 1st of January, 1879, was designated as the day upon which payments in specie would be resumed, and the Secretary was authorized to sell bonds

¹ The amount outstanding in 1874 was \$440,900,000, of which \$58,900,000 had not been put into circulation.—“Report on the Finances for 1874,” p. 383.

in order to secure gold "to the extent necessary to carry this act into full effect." The act was simple and courageous, and the only criticism that may be offered upon it is that it was so long delayed.

The analysis of this chapter permits us to adopt the following conclusions :

Floating debts at the close of a war should receive immediate attention, because they weigh more heavily on public credit than other forms of obligations, and because their maintenance opposes the quick and easy establishment of sound business relations.

If a country emerge from a war burdened with irredeemable paper notes, it is wise to set on foot at once a policy of contraction, since in this manner the country may hope to evade the full consequences of an inflated currency.

We were also led to approve the principle underlying the law for the resumption of specie payments, by which the United States came back to a sound monetary basis.

CHAPTER IV.

PEACE MANAGEMENT OF A PUBLIC DEBT.

THERE can be no controversy respecting the purpose that should control the management of a public debt in time of peace. The payments entailed are a continuous drain upon the productive resources of the people, and it consequently becomes the duty of the financier to lighten by every honest means the burdens thus imposed. Under the guidance of such a purpose, we are led to recognize three ideas which may properly direct the peace policy of any government.

1. The evils of a debt may be mitigated if public obligations are made to perform some useful service.
2. The burden of a debt may be lightened by reducing the rate of interest paid.
3. The burden of a debt may be extinguished by repayment of the capital borrowed.

Three distinct problems are thus introduced ; the first pertains to the profitable use of the debt, the second to the conversion of the debt, and the third to the payment of the debt. The last of these is of sufficient importance to claim for itself a separate chapter, the others will be taken into immediate consideration.

Profitable Use of Public Debts.

A public debt comes to be of general convenience when of such form and character as to serve the purpose of investments, or as the basis of contracts. It should then be the first object of the financier to so fashion the public contracts

under which a debt is held as to meet the demands of commercial transactions. It does not seem necessary to enumerate and classify the various investors in public bonds whose needs should be consulted. Such a classification would include men who desire to live from the proceeds of past accumulations, trustees with estates to manage, corporations whose business demands temporary investments and securities that can be quickly turned, besides others that will readily suggest themselves to the reader. To serve in the highest degree these several demands, the entire debt policy must be clear and simple. Good financing will avoid an involved scheme of funding, like that, for example, adopted by Mr. Hamilton in reorganizing the Revolutionary debt. Such a scheme may be good for speculative purposes but not for permanent investment. The creditor, also, should be granted every possible security against loss by fire or theft; and to this end it is advisable to apply as far as possible the policy of registration which provides two distinct evidences of indebtedness. In this regard the plan adopted by the United States is worthy of full commendation, which permits any holder of coupon bonds to convert them into registered bonds at will.

The general principle that should control in giving shape to a debt in time of war has been already discussed. The government, as a seller of debts, desires to secure the highest possible price for its obligations, and to that end should consult the wishes of its customers; but the application of this principle in time of peace does not call for so great a variety of debt paper as during the continuance of a war. Nor is it necessary that temporary expedients during a period of quiet, should exert as great an influence upon the form of the debt as in times of exigency.

But how, it may be asked, is a financier to know if the form of obligations meets the wishes of the purchasing public? There is, upon this point, a sure test. Assuming, of course, the credit of the government to be stable, public stocks ought always to be quoted higher than the correspond-

ing stocks of private concerns. This will be readily recognized when one notices the difference in the nature of the risk in the two sorts of securities. A railroad bond, for example, and a public bond are alike in this, that neither is evidence of ownership in any particular thing, but both testify to proprietorship in a specific claim. The difference between them is, that the proprietor of the former lays claim to a definite portion of the earnings of a particular industry; while the proprietor of the latter has a lien upon the product of the general industries of the country. Some accident in the particular industry considered, or a period of commercial depression, may deplete the fund out of which the holder of private stocks is paid; but nothing short of a national calamity can extinguish the fund out of which the holder of public stocks secures his annuity. Public stocks, therefore, rest upon a broader basis than private stocks; they involve less commercial risk, and for that reason should be quoted relatively higher. Whenever this is not the case, there is just ground for criticising the administration of the Treasury Department.

It may be objected that the rule here laid down panders to the interests of the bond-holding class, but a moment's consideration will show such an objection to be altogether untenable. It is assumed that no favor will be shown the public creditor detrimental to the public interest. The only question here under consideration is how the debt may be made serviceable while it exists, and in all that has been said the superior right of the tax-payer has been held in view.

But of more importance than this is the thought that by adjusting the public bonds to the wants of investors they will rise in price. The supply being a known, limited, and perhaps a decreasing quantity, the more widely spread the demand, the higher will be the quotations of public obligations. The full advantage of this will not be seen until we have studied the question of conversion of public debt; yet this much may be said at the present time, that the higher the price of the bonds, the less will be the rate of interest

with which the public creditors express themselves satisfied. If, then, no obstacle lie in the way, the government, by an appreciation of its bonds, finds itself in a position to borrow money at cheaper rates with which to pay its old creditors, and so save the difference in interest. It thus appears that by meeting the wants of investors the financier is taking steps which will eventually permit a decrease of the burden of the debt.

Another question which presents itself naturally in this connection pertains to the use of public bonds as the basis of public banking. It is now quite generally admitted that governments should in some manner control the issue of notes used as money. It would be out of place in this essay to discuss the relative merits of bank bills and treasury notes, but, assuming that banking establishments, as centers of issue, are a necessary part of the commercial mechanism, the wisdom of employing public stocks as the basis of such issues will hardly be denied. This fact discloses a new principle for shaping the administration of a public debt in time of peace. It should be the purpose of the financier to maintain harmony between the banking laws and those laws which, in their working, subject the debt to continuous modification, so that, while the debt lasts, the banking establishment may never become embarrassed. In this respect the policy of the United States is open to fair criticism; but as the problem suggested pertains primarily to the management of the sinking-fund, its discussion may with advantage be postponed until that subject claims our attention.

But there remains one question respecting the profitable use of public debts that can not be thus lightly passed. One at all acquainted with business knows to what extent government bonds are used as pledges for the fulfillment of commercial engagements. Purchases, in the ordinary course of trade, are seldom made with cash, nor is any great enterprise set on foot without creating against it many obligations. Among the many forms of collateral securities none take precedence of the promises of a well-established government,

and it is easy to perceive their peculiar fitness for this service. The annuity which they pay is independent of any particular business venture, their amount can not be increased or decreased without full knowledge on the part of the public, they are as easily sold as any other sort of paper, while any change in their permanent price will probably enhance their value ; it is for such reasons that public paper is so readily accepted as business security.

This fact, that public securities are closely interwoven with business transactions, brings to view a most important question of treasury management. Stated in its broadest form it is as follows : Is it wise to grant the minister of finance any discretion in the control of the debt, or should a treasury policy be permanently fixed, legally declared, and invariably followed ? The occasion upon which the administration will be likely to receive strong appeals to depart from its ordinary rules is the advent of a commercial panic. All grades of securities then fail to find purchasers, and many men whose assets exceed their liabilities stand in danger of commercial ruin. The difficulty arises from the fact that extensive liabilities are an essential part of business life, and that failure to meet one's obligations the moment they become due is confession of bankruptcy ; it must therefore follow, when men feel any pressure coming upon the money market, that they will hold on to what cash they may have and endeavor by all means to secure more. That which is in universal demand is money ; that which is offered for money is securities of all sorts, and among them public obligations. When it is discovered that the ordinary purchases of securities are not made, the wildest excitement is apt to prevail, and every creditor hastens to his debtor demanding immediate payment, and payment is cash. Confidence is lost in men because confidence is lost in securities ; fear and suspicion, like a contagious disease, spread from mind to mind, and the country finds itself without warning in the fever heat of a commercial panic. At such times it does no good to philosophize about panics. Something must

be done to calm excitement and to allay suspicion, for so intimate are business relations that the innocent and the blameworthy are alike ruined by failure of confidence.

The first thought that suggests itself to men under such circumstances is to appeal to government for relief. But what can a government do? The usual resort of writers, when discussing the theory of panics and their relation to government policies, is to the history of the English Bank Act of 1844; but so frequently has the public been entertained by a recital of this dull chapter in financial controversy that I venture to assume an acquaintance with its main features on the part of my readers. This history is, however, pertinent to the question in hand, for it places beyond reasonable doubt the ability of a government to allay a panic by making its appearance in a judicious manner upon the money market. In England this end is secured through a suspension of the Bank Act, the virtual effect of which is to permit the bank to issue notes without the usual deposit of gold. This creates the impression that any person who holds good commercial or government paper can procure as much money as he needs, and the result is that cash is no longer hoarded; for one of the strange things about a panic is that as soon as cash is freely offered no one wants it.

But this, it is said, has nothing to do with the management of a public debt; and, so far the United States is concerned, the Federal government can not suspend a law which requires a deposit of gold for every note issued, for it has no such law. The propriety of thus referring to the English Bank Act will be perceived when it is learned that there are those who believe the Federal government is in a position to exert an analogous influence upon the money market, by a departure from the ordinary rules of managing its public debt. It must be held firmly in mind that the failure of confidence in times of panic does not so much attach to men as to their ability to negotiate securities, and that the offer of ready money upon the market is able to

overcome this distrust. Now it is claimed that a government that carries a great debt, and which controls the issue of notes, is in a position to grant relief in times of pressure, and this in three ways. It may anticipate interest payments upon its own debt; it may employ its surplus revenue by unusual purchases of public securities; and it may, provided any law grant such authority, offer to purchase bonds to unlimited amounts by an issue of legal-tender notes. This third plan is, for all practical purposes, an offer to convert interest-bearing bonds into legal-tender notes bearing no interest. These measures would undoubtedly arrest a panic, provided they were able to create the impression that the government was willing to furnish a sufficient amount of paper clothed with the legal power of paying debts.

It must be admitted that there are certain objections against any interference on the part of the state. Many would urge that, by such a measure, the government oversteps its proper functions; but this is certainly begging the question, for it assumes some fixed rule determining proper functions. With more reason may it be argued that a dangerous power is entrusted to the administration when he who controls the public debt can fashion the treasury policy to meet the changing demands of a market. There are men whose political creed is bound up in the word "friendship"; might it not then easily occur that political friends would be served, and political foes be refused assistance, and in this manner the discretion granted the minister of finance be turned to the account of electioneering? There is undoubtedly this danger, but, before conceding this argument to be final, it may be well to inquire if it is the part of wisdom to refuse an administration the liberty to render a positive service because that liberty may be abused. This question is at bottom one of political philosophy, and may not claim our present attention; it will probably be answered according as the reader has adopted the restrictive or the extensive theory of governmental functions. For my own part, I believe that good government is more likely to be secured by

increasing personal responsibility than by restricting the functions of the state within such narrow limits that only men of ordinary strength of character and inferior talent will be drawn to a public career; I must, therefore, regard as untenable this argument for refusing any discretion to the Secretary of the Treasury in the management of a public debt.

Yet another thought stands opposed to the appearance of the financier upon the money market. It may be said that there is danger in thus magnifying the ability of the government to grant assistance in times of panic. The policy of aiding solvent firms would encourage recklessness in business management, and thus multiply the occasions on which assistance would be demanded. This, however, does not seem to have been the result in England, where it now stands as an unwritten law that the Bank Act shall be suspended whenever demanded by the exigencies of the market. Nor can one easily understand how such a result should follow. A panic is not a corner; it can not be manipulated into existence. The purpose of governmental assistance in sustaining those who are engaged in sound business enterprises, is to prevent their being involved in the ruin that follows the collapse of worthless securities; how, then, may one justly conclude that an expression of willingness to render such assistance as this will encourage men to fly the kites of speculation? Indeed, the reverse of this will be true. Speculative methods are encouraged when business is so organized that the fall of a reckless firm may bring ruin upon a house whose methods are sound. So long as speculation succeeds, it is the source of high profit, and, if the danger arising out of it is common to all men, each will feel the temptation to indulge in reckless ventures. It is the knowledge that a business will stand upon its own merits in the day of trial that holds out the best inducement to conservative management, and this may be obtained by providing for the ready conversion of all good securities into cash on demand.

But, turning to the second point: Will the habit of too great dependence upon government be engendered if the

state proffer its assistance to solvent firms? Without doubt the administration should not be officious in granting its aid, nor offer this upon such favorable terms that men will relax their exertions to extricate themselves from difficulties. This self-help in time of panic can only come through an agreement on the part of the banks to accept something besides legal tender in the settlement of balances. Thus, in the panic of 1873, the clearing-house of New York city rendered marked service by creating a paying medium, receivable between the banks, to the amount of \$20,000,000. But such an action as this can not reach the heart of the immediate difficulty, and arrest a panic before it shall have caused the downfall of many solvent houses; for it must necessarily be slow, resting as it does upon the deliberation and consent of a large body of men; nor is it adequate to allay that unreasoning fear which impels every man to demand cash. Nothing can do that but cash in sight. Thus, while this objection is very pertinent in suggesting one of the rules according to which assistance should be rendered (as will shortly be shown), it does not oblige one to deny the wisdom of any assistance whatever.

The principles that should control in adapting the management of a debt to the temporary relief of the market may perhaps be the most advantageously discussed by a study of the action of the Federal officials during the panic of 1873. It will be remembered that this panic was precipitated by the failure of Jay Cooke & Co., on Thursday of the third week in September, and upon the Friday following, known as "Black Friday," there was, in the city of New York, a general collapse of banking-houses whose solvency had been to this time unquestioned. Upon Saturday there was a rumor that Secretary Richardson would deposit \$10,000,000 in the banks of the city, so as to furnish ready cash; this caused a momentary feeling of confidence, but distrust again returned as soon as it was known that the rumor was without basis. The President came to New York on the evening of Saturday, and held a consultation with the prominent mon-

eyed men respecting the assistance which the administration might render. Nothing was definitely decided until the advent of the Secretary of the Treasury, but on Monday notice was given that the Government would employ its surplus revenue in the purchase of five-twenty bonds, paying therefor in greenbacks the par value of the bonds estimated in gold. This was a modification of the treasury policy to meet a temporary demand of the market, for it did away with the purchase at stated days and in sealed envelopes, and offered to take all bonds that should be presented at an advertised price. It should be noticed, however, that the surplus revenue was only \$14,000,000, and, in consequence, that this offer to furnish money was a limited offer. Later, the government acceded to the appeals of the street, and proposed to anticipate the payment of November interest upon the public debt—a measure which placed some \$8,000,000 within the reach of those who desired money. If the previous discussions of the general principles involved have been accepted, no objection can be made to the purpose that inspired the administration. These payments could in no way involve loss to the government; the cash was on hand, or could be easily procured, the market was in pressing need of the money, and it was known that the longer the panic endured the greater would be the permanent injury to the business of the country. In carrying out this measure, however, there are two particulars in which the actions of the administration are open to fair criticism. This assistance of the government would, in the first place, have been much more effective had it not been so long delayed. It is hardly just to censure the Secretary for not possessing the gift of prophesy, and foreseeing that Friday was to be the black day of the decade; but a people has the right to claim that the man intrusted with the treasury portfolio shall know enough of the theory of trade and finance to enable him to decide promptly when facts are made known. The first question, and, indeed, the important one, to be decided is, whether the administration shall under any circumstances make its

appearance upon the money market except in conformity to fixed rules; and that should have been settled, so far as the Secretary was concerned, before he ventured to fill an office bearing such grave responsibilities. Assuming this first question to have been answered by him in the affirmative, the second presents itself only with the emergency, and asks if a crisis is so great as to warrant interference by the Federal government. In the panic of 1873 this might have been answered by a wise man early on Friday, and a simple notice that the Secretary would appear on the market and purchase public stocks would have allayed for a time at least the unreasoning fear of creditors.

A further lesson presents itself from a study of the part performed by Secretary Richardson in the panic of 1873. The money furnished by him did not seem to grant the relief that was expected, because it was placed upon the market in such a manner as to find its way into the hands of those who did not really need it. We may with propriety again refer to the rule adopted by the Bank of England for placing the notes issued under the suspension of the Bank Act. The attitude of the bank was such as to say to those who rushed like madmen about the streets in search of money: Here is all the money you want ready at hand, but you must pay for it a high figure. That is to say, it placed its discount so high that only those who were in imperative need of the money would consent to the loss which would attend the realization of their securities. In 1847, the panic is said to have disappeared in ten minutes after it was known that the Bank Act had been suspended, but since the discount upon securities was placed very high, the bank was obliged to issue only about £400,000 of notes. In 1857 and 1866, similar results followed the same act on the part of the government, but in these cases the bank was prohibited from granting any discounts less than 10 per cent. The principle here involved is quite plain. This money which the government provides must not be hoarded, or the purpose for which it is provided will be defeated.

In 1873 this rule was disregarded, and the well-meant endeavor on the part of Secretary Richardson was in large measure rendered abortive. The Secretary purchased bonds in legal-tender notes, paying for them their par value in gold. Gold was quoted in currency at 111, while bonds ranged about 115; the loss, therefore, to one who secured legal tender upon sale of such securities was equivalent to a discount of about 3 per cent, and this rate was not sufficiently high to prohibit the conversion of debt into legal tender for purposes of hoarding. The fact is that the greater portion of this money found its way into the reserve or deposits of the savings-banks, but as the savings-banks availed themselves of that clause upon which their business is transacted which permits them to refuse payments upon deposits for three months after notice, there was no way in which this money could be brought again into general use. One is then obliged to say that the business community received but little advantage from the assistance which the Secretary endeavored to grant, but that this is due rather to inefficient management than to the fact that relief lay outside his ability as head of the Treasury Department. He should have earlier declared his intention, and he should have driven a harder bargain with his customers. Suppose he had offered to purchase bonds at their par value, estimating greenbacks as gold; it is not probable that he would have found many to accept his offer, but the knowledge that the money was offered and could be obtained when needed would have allayed all fear. It is from such criticisms as these that the rules are to be disclosed according to which a treasury carrying a heavy public debt should be managed in time of panic.

But what may be said for the proposal that interest-bearing bonds should be converted into treasury notes? Oddly enough, something quite analogous to this came up in 1873. It will be remembered that Secretary McCulloch endeavored to contract the currency by withdrawing greenbacks from circulation. Such notes as were withdrawn were

not destroyed, but kept in the treasury, and when the policy of contraction was arrested, under Secretary Boutwell, that brilliant financier conceived the idea that this fund constituted a treasury reserve. What it was a reserve to, or why a reserve was needed, no one ever knew, for there were no obligations created against the greenbacks thus withdrawn. It was claimed that this fund could be re-issued at the pleasure of the government, and in 1878 strong pressure was brought to bear upon the administration to induce it to expend this fund in the purchase of government securities. To this the President would not consent, for he conceived that no legal authority existed for such a procedure.

In discussing a proposition of this sort, we must first learn why the notes issued are accepted by creditors. Is it because they are legal tender or because they are convertible into gold? It is believed that the advisability of the issue of new notes in time of panic must differ according as one or the other of these assumptions is found to be realized; and the reader is especially requested to hold in mind that if notes are convertible into gold, there is no need of a legal-tender clause in their issue. In the monetary condition of the United States previous to 1879, when specie payments were resumed, the power of re-issuing at pleasure a large amount of irredeemable notes was full of danger to commercial interests. Whatever evils are inherent in arbitrary changes in the amount of money attaches to this power, for, since the notes are irredeemable, they do not possess the ability of self-retirement after the exigency has passed which called for their issue. It is true that the government might provide for their reconversion into interest-bearing bonds, but it has been shown by experience that this is not a sufficient guarantee against inflation. We are, therefore, constrained to conclude that the President was wise in opposing the employment of the "reserve fund" for the purchase of bonds. And yet the argument in favor of such a measure, although not conclusive, is very strong. Unless it is known that the ability of the government to grant assistance in

times of pressure is without limit, all its proffered help may be futile. The reason why a suspension of the English Bank Act is able immediately to restore confidence is that every solvent house knows that the bank's funds are unlimited, and that every business man with good securities is safe. But if the assistance of the government can not extend beyond the surplus it happens to have on hand, there is no assurance that its strength is adequate to the task it undertakes. "Under the present system of Commercial Credit," says the economist Mr. MacLeod, "there must be some Source with the Power of issuing undoubted Credit to support Solvent Commercial Houses in times of Monetary Panic," and he prints it in italics. Without the power of issuing notes at discretion, the government can not furnish this undoubted credit; with the power to issue irredeemable notes, all business is thrown on that uncertain basis which arises from money not self-regulating but Congress-regulated. Certainly the position of a financier under such conditions is far from agreeable. His decision must in either case be followed by serious consequences. But, all things considered, it seems wiser to permit a panic to wear itself out rather than grant to any administration the power of inflating the currency at pleasure.

But at present United States notes are redeemable in specie. Let it be assumed that gold is the only paying metal (or that other nations have also adopted silver as part of their monetary system), the money of this country would then be self-regulating, and continue to be self-regulating as long as specie payments were maintained. The Federal government would, under such conditions, have as full and complete control over a panic, by an offer to convert bonds into notes at the pleasure of the holder, as has the government of England when, acting through the bank, it offers to discount commercial paper with new notes. And it would be wise for Congress to provide a law granting to the administration such discretion in the peace management of the public debt that, while the debt shall continue, it may

serve as ballast for commercial enterprises. Suppose that notes were issued in consequence of such a law, they could not effect inflation, for the amount issued would be quickly withdrawn, being reconvertible into bonds, and convertible into specie; but if the financial history of England is worth anything as evidence of what would take place, the practical effect of the law would be secured without an issue of notes.

Conversion of Public Debts.



In continuing the line of this discussion as proposed, our attention is now drawn to the topic of conversion of public debts. The process of conversion may be technically defined as a financial operation addressed to the form of a public debt already in existence. Since contracts of this sort are expressed in terms of principal, rate of interest, and time, a change in any of these items may be properly regarded as constituting a conversion; but for the most part the study that follows will be confined to changes in the rate of interest.

The immediate effect of an operation that reduces the rate of interest upon public bonds is to decrease the burden of a debt. The money thus saved may be remitted to the people by reduction of taxes, or it may be devoted to the extinction of the principal of the debt.

But under what conditions will it be possible to induce creditors to submit to decreased interest? It is, of course, not contemplated that a state shall employ its sovereign power to enforce modifications of the contracts into which it has freely entered. Such a procedure would be repudiation, and not voluntary conversion. It is assumed throughout this discussion that the state acknowledges in the spirit of honor and integrity the terms of the obligations it has created against itself.

A government is in a position to secure a reduction in the rate of interest which it pays when it holds the legal right to expunge the debt through payment of the principal, and when the ruling rate for money upon the market is less

than the rate mentioned in the bond. These two conditions fulfilled, a government may say to its creditors: You must either consent to receive less for the capital you have intrusted to us, or the amount of capital called for in the bond will be returned to you and the debt discharged.

It seems almost unnecessary to arrest our study at this point for the purpose of showing that a government is justified in thus reducing the burden of a debt. An operation of this sort appears altogether appropriate, at least to the people of the United States. In this country, as well as in England, a fall in the market rate of interest below the treasury rate imposes a duty upon the government to secure to the taxpayer the benefits rendered possible by such a state of affairs. Yet, strange as it may seem, there have been cases in which the influence of debt-holders has been successfully urged against any reduction in interest. This occurred in France between 1878 and 1883. At any time during these years the condition of the money market was such that large savings might have been easily effected by reducing the rate of interest paid upon the public debt, yet no ministry dared undertake the measure for fear of political consequences at current elections.

"The state had borrowed in a moment of distress," says M. Mathieu-Bodet, "at the rate of 6·06 and 6·29 per cent; it is now able to secure so much capital as is necessary to repay this debt at less than 3·75 per cent." The possible saving arising from this relation of market rate to the rate paid on the bonds was recognized by economists, financiers, men of affairs, and men of the state. In 1879 the chambers appointed a commission empowered to carry through a plan of conversion. The minister of finance came before the commission and declared "that it was impossible." The secret of this extraordinary procedure was that Gambetta, at that time practical dictator in France, feared the effect of such a measure on his own and his party's power. An historian of the finances of the Republic adds in relation to this matter: "In 1880 and 1881, as in 1879, the circumstances were propitious; rates were

favorable were for conversion ; money was easy ; no crisis had yet borne upon exchange. In 1880, the successor of M. Say, M. Magnin, was in a position to repair the error of 1879 ; but the interdict was not yet raised, and M. Gambetta conserved his power. For the rest, the approach of the elections led the minister, the commission, and the Chamber, little by little, to the views of the dictator ; the deputies commenced to think that the holders of the bonds would be little satisfied with the reduction of their payments, and that the tax-payers had little taste for the economy ; they feared the hostility of the one class without counting very much on the favor of the other.”¹

I have called this an extraordinary procedure. It certainly appears so. It indicates that the French people do not possess the financial sense in a high degree, otherwise they could never be deceived by the sophistry that it is a good thing to pay taxes in order to secure payment on bonds. This is altogether akin to the old error that a public debt can not impoverish a nation, because the payments it occasions are but payments from the right hand to the left. Even supposing the debt to be distributed among the people in proportion to the demands made upon them for contributions, there would yet be an actual loss in shrinkage while the taxes are passing through the hands of the government. Indeed, the considerations which lead to the conclusion that public justice demands conversion, when admitted by the terms of the contract, are so self-evident that their statement appears puerile ; and the fact that French writers on finance regard the careful presentation of such considerations necessary forms one of the most severe criticisms upon the financial ability of that people.

But does the conversion of a public debt meet with the approval of public economy, as well as conform to the demands of fair dealings ? Certain curious arguments have arisen respecting the question thus introduced. It is some-

¹ Cf. “Les Finances de la République,” H. Le Trésor de la Rocque. Paris, 1884, pp. 24-29.

times urged that a reduction in the rate of interest paid by the state is opposed to public welfare, because this tends to force the rate of profit in the community down, and this is conceived to be prejudicial to industrial prosperity. On the other hand, they who propose a forced conversion of public debt, reducing the government rate below the market rate, rely upon the same premise for their conclusion. Low profits, they claim, follow conversion; this leads to low prices, and low prices are desirable for the community. It is unnecessary to pass judgment between these conflicting claims, for the truth is that the premise upon which they both rest is wholly untenable. It is not within the ability of a government to permanently affect the rate of profit in a community by changing the rate paid upon its debt. The rate of profit is determined by general industrial conditions. One must not assume to understand this subject until he perceives that a conversion of a public debt, by which interest payments are reduced, is a resultant and not a causal fact. It is of no importance, therefore, whether the claim here stated be urged for or against conversion, it is equally untenable in either case.

Such considerations as these suggest in what manner the public financier should approach the study of refunding operations. He should conceive that the administration stands with regard to them as the directing board of a great business corporation. This is true, because in this matter there can be no disparity of interests between the government as a corporation and the subjects of the government as tax-payers. Questions of refunding, therefore, are much more simple than they at first appear, for they come under the general rules of common business.

It may be a trite saying, and yet it is an important truth, that the first step toward conversion is the establishment of public credit. So far as a government is concerned, a reduction in the rate of interest paid on public obligations is the only means through which it may avail itself of the benefits that spring from a rise in its own credit. Thus, if the ne-

cessary taxes are levied, if obligations are reduced to clear and simple form, if demand for variety be duly appreciated, and if all question of fair dealing are placed beyond reasonable doubt, confidence will be firmly established in the ability and willingness of a government to meet its contracts, and its bonds will consequently be eagerly sought by all investors. The market being in this manner extended, competition will arise among the purchasers, and stocks will be quoted at premium, although the government has reserved the right to redeem them at par. It is under such conditions that the burden of a debt may be reduced, and the reduction is properly accredited to the administration as a reward for public honesty and sound financial management. Financial writers have always been willing to grant due praise to those statesmen who have brought about a decrease of interest charges, for they fully recognize that the honor of such a transaction belongs to those who have sedulously guarded and persistently supported the public credit. A quotation from Sir Stafford Northcote, descriptive of a refunding operation in England in 1844, may not be inappropriate as illustrating this point :

Mr. Goulburn brought forward his plan for this conversion on the 8th of March, 1844. It was not the first occasion upon which he had had to perform such a task ; for it had fallen to his lot, in 1830, to propose and carry a reduction of interest upon a large part of the very stock with which he was now again to deal ; and it was natural that he should feel gratification at being a second time able to propose so material a relief to the country. He was able, too, to claim for the Government of which he was a member a considerable share of credit for the policy which had contributed to bring about the satisfactory state of the money market which rendered his operation possible. How far the revival of trade and the industry of the country was to be attributed to their measures was, of course, a matter open to question ; but it was evident that their firm determination to avoid a recurrence to any system of loans for the purpose of meeting the deficiencies of the revenue, and to supply those deficiencies by fresh taxation, and their success in strengthening the balances in the Exchequer, and dispensing with the necessity of leaning on the Bank for support, had directly tended to raise the price of the funds. At the accession of the Government to power, Consols had stood at 89 ; they

now stood at 99. The balances in the Exchequer, which at the commencement of the year had been as low as £1,400,000, had risen to £4,700,000. There were no Deficiency-bills unpaid, nor had it been necessary to have recourse to the Bank for advances in anticipation of supplies during the whole year. The amount of Exchequer-bills in circulation was between £18,000,000 and £19,000,000 only, an amount then considered low in comparison with previous years; the interest upon them was but £2 4s. per cent, and they commanded a premium of £3 13s. per cent in the market. There could be no doubt that the firmness of the Government and of Parliament in submitting to the Income Tax, rather than stave off the evil of a growing deficiency by resorting to a loan, had contributed materially to this satisfactory state of things; and the country was now to reap the just reward of its exertions for the maintenance of its public credit, in the reduction of the rate of interest to the public creditor.¹

We are led next to consider certain technical questions that arise in carrying through a policy of conversion. With regard to the time at which this policy may be set on foot, the ground for decision is altogether plain, but the details of conversion are by no means so simple. Contrary to the definition given above, a refunding law usually assumes that an old debt is to be extinguished and a new one created. It is not admitted that the new bonds represent the old with changed stipulations. If, for example, we turn to the act of 1870, which authorized the refunding of the national debt of the United States, it will be noticed that the first section of this law proceeds as though a debt were to be created. The Secretary of the Treasury is authorized to issue bonds of three sorts, each to a limited amount, the time of redemption being carefully stated. There is no reference to the existing debt, except in the last clause, which specifies that "nothing in this act, or in any other law now in force, shall be construed to authorize any increase whatever of the bonded debt of the United States." The wording of the second section, also, maintains the assumption that the debt created is a new debt. By it the Secretary of the Treasury is empowered to

¹ "Twenty Years of Financial Policy," by Sir Stafford H. Northcote, Bart., pp. 54-56.

sell the bonds issued under the act at their par value in coin, the proceeds of which shall be devoted to the redemption of the outstanding "five-twenty bonds," or to accept in lieu of coin the old debt at par. That is, subscriptions to the new debt may be made either in money or in old stock.

Should one inquire why governments proceed upon the assumption of creating a new debt in fashioning their refunding laws, two replies present themselves. In the first place, this is the most simple method of procedure. The public book-keeping is in this manner guarded against complications of any sort. One account is expunged before another is begun. But of more importance than this, the government, by adopting this method, avoids every appearance of exercising undue pressure upon its creditors. One condition of the old debt is that a stipulated annuity will be paid as long as the principal remains unpaid; in order, then, to reduce the annuity, the technicality of law requires the creation of a new principal. In this manner any creditor who is not satisfied with the rate of interest on the new bonds may receive his capital in disposable form. The practical bearing of this view of a refunding operation is, that the offer of payment should be made in good faith by the government, and under such conditions that the demand of any creditor who desires cash instead of new bonds may be promptly met.

It is not, however, necessary, in order that the offer of a government be sincere, that a sum of money should be collected adequate to the payment of the entire debt. It is only required that public credit should be so firm, and the money market be in such a condition, that the administration is morally certain of its ability to borrow fresh capital at the rates for which it offers its new bonds.

Again, in order that a refunding operation may be successfully carried through, the new bonds should grant some immediate actual benefit to those who are willing to accept them in lieu of the old; for in this manner the transaction will not call for the handling of any considerable amount of money. There can, of course, be no advantage in the condi-

tions offered by the new debt over those granted by the old, but the contract on the new debt may be so drawn as to invite purchases when capitalists compare this method of investing their money, with investment in other forms of productive property. This does not mean that governments must pay a higher rate of interest than other investments can pay. The several terms of a debt are, within limits, transmutable. As motion may be changed into heat and heat into light, so security may be transmuted into length of investment and length of investment into rate of interest. This being true, it follows that the financier can depress any particular element of a bond by emphasizing the other terms of the contract ; and this he should do in favor of a low rate of interest, for it is the annual interest-payments which constitute the immediate burden of a public debt. But because of the many ways in which public obligations may be used in private affairs, they who lend the money regard time for which investments are made and stability of value as of greater relative importance. It seems, then, possible for the financier to depress the rate of interest to a low figure while yet offering investors some decided commercial advantage over other forms of investment, and this he can do by stipulating that the new bonds shall be subject to no further alteration for a specified term of years. Without this guarantee a bond bearing a low rate of interest will not float at par.

But what is the proper time for a guarantee to run ? No definite answer to this question can be given except in the presence of known conditions, but we may consider the principle according to which it should be determined. This decision of the financier depends wholly upon the policy that has been adopted respecting the payment of the debt. Upon the theory of permanent indebtedness, the consideration of a low rate of interest ought to outweigh that of control over the form of the debt, and the time of guarantee should then be based upon an estimate of the probable future fall in the market value of money. That is to say, no gov-

ernment should contract itself out of the right to make a further conversion at some future time in order to secure a slight immediate reduction in the interest-payments. If the commercial forces are such as to depress rapidly the rate of interest, and if it is probable they will continue to operate, the guarantee against new conversion should not be for a long period; but if, on the other hand, the market rate for money is already as low as may be reasonably expected for some years, the time may be more extended. The rule that applies to old countries can not be accepted by new and rapidly developing peoples.

Assuming, however, the policy of debt payment, another element bearing on this question is introduced into the calculations of the financier; but in this case the rule is quite simple. The administration should assent to no plan of conversion by which the policy of debt payment may be embarrassed. This rule has been frequently disregarded. In the financial history of our own country there have been two instances in which the Secretary of the Treasury has found it impossible to apply in a judicious manner the moneys appropriated for the extinction of the debt. The first of these was the occasion of much complaint by Mr. Gallatin between 1806 and 1811. As has been already stated, the financial operations of the Federalists had thrown a large part of the debt into a form which permitted payment only at the rate of a twenty-four-year annuity. But, as Mr. Gallatin had secured an annual appropriation of \$8,000,000 for the service of the debt, all obligations payable at the pleasure of the government, except the three per cents, were quickly expunged, and the Secretary consequently found it impossible to apply in a judicious manner the surplus which he had with so much labor secured. Had Mr. Gallatin managed the refunding of the original debt, or had Mr. Hamilton managed the payment of the refunded debt, this embarrassment would not have made its appearance; but this incident well illustrates the antagonism that exists between the policies of conversion and payment. The other case is of slight importance. It oc-

curred in 1829. The debt available for payment amounted to \$9,800,000, and the surplus revenue for the year was \$12,000,000.

But the refunding act of 1870 is open to just criticism from this point of view. Up to the present time there has been no difficulty in applying surplus revenue to existing obligations, but the present guarantees against redemption are such that the government must soon experience the embarrassment of endeavoring to carry on the policy of debt payment. Besides the five-per-cent, two classes of bonds were created—those bearing $4\frac{1}{2}$ per cent interest, redeemable September 1, 1891; and those bearing 4 per cent interest, redeemable July 1, 1907. The amount of the former is \$250,000,000; that of the latter is \$738,000,000. In addition to these, there are the three-per-cent bonds redeemable at the pleasure of the Government, now amounting to \$194,000,000. The permanent appropriation due the sinking-fund is about \$45,000,000, but for our present calculation should be put at \$50,000,000. Assuming that this appropriation will be applied to the redemption of the three-per-cent bonds, it appears that there are enough of these bonds to absorb the sinking-fund payments for four years, which would bring us on, in the policy of debt payment, to the year 1890. At first glance it appears that the calculation of our financiers was quite accurate, for but one year intervenes between the expungement of the three-per-cent bonds and the time when the four and a half per cents become redeemable at par.¹ But this conclusion overlooks the fact that surplus revenue can not be added to the sinking-fund payments, as has heretofore been the custom.

But, passing to the year 1891, how will matters then

¹ The figures are changing so rapidly that a correction in the text does not seem to be the most pertinent method of portraying the full strength of this argument. As this goes to press, the monthly statement for December, 1886, shows that \$78,000,000 only of the three per cents remain unpaid, and the President in his message assumes that the entire amount will be paid during the coming year. Yet the calculation in the text is based upon figures which were correct a year ago.

stand? In that year a sum of debt capable of absorbing the sinking-fund appropriations for five years will come under the control of the government. But no other bonds are redeemable until 1907. It seems, then, that in 1896 the administration must adopt some other method of paying the debt or suspend for a term of years the sinking-fund appropriation. To adopt this second suggestion would be, for all practical purposes, to decide upon the maintenance of a debt of three quarters of a billion, for taxes once remitted are with difficulty re-imposed for the purpose of paying a debt. Still, it can not be said that this is a serious criticism upon the refunding act of 1870; the greater blame lies with those who now profess to manage the financial affairs of the country.

Perhaps there is no temptation presented to the financier so alluring as that which leads him to sacrifice control over a debt for a slight though an immediate reduction in the annual payment for interest. Suppose, for example, that money is worth 4 per cent, but that the government is paying 5 per cent upon outstanding bonds. It is certain that, with a ten years' guarantee, the debt of the country may be converted into a four-per-cent bond issued at par, thus permitting a saving of one fifth of the previous annuity. But the financier is not satisfied with this. He sees that, by granting a guarantee against new conversion for twenty or thirty years, he can yet further reduce the immediate burden of the debt, and the greater the reduction the greater will be his popular reputation. Few men can withstand such a temptation, but it is against this choice that sound financial principles utter their strongest protest. It is altogether probable that, before the thirty years shall have expired, a lower rate of interest than the actual rate paid might be secured, in which case what is gained at the beginning of the period is lost at its close. The present quotations for the four-per-cent bonds show that, were they now under the control of the government, they might be reconverted into bonds bearing 3 per cent interest. There is thus disclosed an unneces-

sary annual payment of one per cent upon three quarters of a billion of money, resulting from an error in judgment on the part of Congress in 1870, and this payment must continue till 1907.

Other questions of a technical character arise in the course of refunding a public debt. Thus, it is necessary to decide whether the operation shall be carried on so as to decrease the principal of the debt, so as to increase the principal, or in such a manner that the principal of the new debt shall be the same as that of the old. In the first case, conversion is said to have taken place at premium; in the second, at discount; in the third, at par.

Conversion at premium is never adopted with a view to lighten the immediate burden of a debt, but rather as one of the means of extinguishing its principal; its consideration, therefore, finds no place in our present discussion. And, so far as the other plans of conversion are concerned, it is only necessary to clearly understand what is meant by the terms, and it will at once be seen that the principles which control the first issue of a debt apply in every particular. A discount conversion is a discount sale of a new debt, the proceeds of which are applied to the extinction of a debt at premium or par. In order to carry such an operation through, there must be created a sufficient amount of additional stock that the total principal of the new debt, at the rate for which it sells upon the market, will equal the par value of the old debt. It need hardly be remarked that the rate of interest borne by the new debt will be less than the rate which an equal amount of free capital would have secured had the conversion taken place at par, and that it is this slight saving in the actual amount paid in interest that recommends discount conversions to the practical financier. But, for the reasons already given, this policy does not meet the claims of sound financing.¹ The immediate saving

¹ Cf. *ante*, pp. 167-177.

It is also necessary for the financier to avoid the entanglements of lotteries, prizes, and tontines as part of a system of conversion. Not only is their use

thus secured will be likely to entail a relatively greater loss in the long run.

The refunding operations of the United States have, for the most part, taken place on the basis of bonds sold at par. The refunding law of 1870 gave large discretionary powers to the Secretary, but in this particular was strict and explicit. It forbade any increase of existing indebtedness. England also, of late years, has adopted this principle. Referring to the last great operation upon the English debt, one learns that the relative merits of the two plans were discussed, but that conversion at par was given precedence over conversion at discount. Sir Stafford Northcote relates the argument of the Chancellor of the Exchequer as follows :

Various plans, said Mr. Goulburn, had at different times been adopted for the reduction of interest upon portions of our debt. Sometimes an addition had been made to the nominal capital of the debt, in order to induce the creditor to accept a reduced amount of annuity ; sometimes the interest had been augmented for a limited period, in order that it might be reduced afterward. In the present instance it was possible to reduce the

evidence that credit is weak, but, in this country at least, they tend to sink credit yet lower. As a matter of curiosity, the following plan of refunding by lottery, adopted in Louisiana, is subjoined :

By an act of March 6, 1876, a "premium bond plan" was established to refund the debt of the city of New Orleans. "The plan proposed was an exchange of outstanding bonds for premium bonds; the latter to be of the denomination of \$20 each, bearing 5 per cent interest from September 1, 1875, payable at no designated period, the interest and principal to be paid at the same time, and not separately, and the maturity of the bonds—principal and interest—to be determined by chance in the drawing of a lottery. One million of these bonds is to be divided into ten thousand series of one hundred bonds each. The ten thousand series are to be placed in a wheel, and, in April and October of each year, as many series are to be drawn as are to be redeemed, according to a certain schedule adopted. The bonds composing the series thus drawn are to be entered for payment three months thereafter, principal and interest, and are to be receivable for all taxes, licenses, and other obligations of the city. At the expiration of the three months, the bond numbers of the drawn series are to be placed in a wheel, and 1,176 prizes, amounting to \$50,000, are to be drawn and distributed. Upon the plan the city is released from the payment of the principal or the interest of its debt, except such portion as may be drawn from the lottery each year."—"United States Reports," vol. ciii, p. 363.

three-and-one-half-per-cent either to a three-per-cent or to a two-per-cent stock, by adding a sufficient amount to the nominal capital of the debt. By the former operation, a gain of between £800,000 and £900,000 a year might immediately be obtained to the tax-payer at the expense of an addition of £10,000,000 or £12,000,000 to the capital of the debt. By the latter the gain would be £1,200,000 a year, but the addition to the capital would be no less than £50,000,000. Mr. Goulburn rejected both these plans; and, preferring the ultimate to the immediate gain, proposed a reduction of the interest on the portion of the debt to $3\frac{1}{4}$ per cent for ten years, and to 3 per cent for at least twenty years more; adding nothing to the capital of the debt, and securing a saving of £625,000 a year till 1854, and of £1,250,000 a year afterwards till 1874, when the debt will be convertible or redeemable at the option of Parliament, should circumstances permit.¹

In bringing this study upon the policy of refunding to a close, it may be interesting to notice how the debt of the United States came to assume its present form. It would have been possible to have taken steps toward reducing the rate of interest as early as May, 1867, for at that date \$178,000,000 of obligations became due, and the total amount maturing in the course of the year was \$925,000,000. There was, indeed, a bill introduced into Congress for selling a five-per-cent bond with which to pay outstanding obligations, but it does not seem to have attracted much attention. In 1868, also, a similar bill passed Congress, but failed to receive the approval of the President. The tide of popular sentiment was at this time setting strongly toward repudiation. The policy of contracting the currency, as a first step to the resumption of specie payments, had been abandoned, and there was a strong feeling that the money good enough for the soldiers was good enough for the bondholders. It has already been pointed out that the saving occasioned by a refunding operation is the just reward of following that line of conduct which leads to high credit. But the converse of this proposition is also true. The maintenance of a high rate of interest is the just penalty which no people can escape for casting

¹ "Twenty Years' Financial Policy," p. 56.

suspicion upon their own promises. This penalty was exacted from the American people for the five or six years following 1868.

It was, however, soon recognized by Congress that no reduction could be effected in the burden of the debt until the specter of repudiation had been laid, and to this end there was passed in March, 1869, an act entitled, "An Act to Strengthen the Public Credit." This act stated that, in order to remove any doubt as to the purpose of the government, "its bonds would be paid in coin." It was then possible for refunding to be undertaken in earnest, and the year following, Mr. Sumner, of Massachusetts, introduced a bill for that purpose which became a law July 14, 1870.

The refunding bill of 1870, which was quite simple, provided for the creation of three sorts of bonds. Authority was given to issue \$200,000,000 (afterward raised to \$500,000,000) of five-per-cent bonds, redeemable after ten years from the date of their issue; also \$300,000,000, redeemable after fifteen years, bearing $4\frac{1}{2}$ per cent interest; also \$1,000,000,000, redeemable after thirty years, bearing 4 per cent interest. All these bonds were to be exempt from either State or Federal taxation, and were made payable at the Treasury of the United States. The Secretary of the Treasury was empowered to sell any of these bonds at "not less than their par value for coin," and to apply the proceeds to the purchase of matured debt, or to exchange the new bonds for those outstanding, "par for par." A sum equal to one half of one per cent was allowed for defraying the expenses of conversion. It is not necessary to give in detail the various transactions by which the Federal debt was changed to its present form. The following table, which presents the status of the debt at the beginning of each fiscal year since 1870, displays the result of the refunding bill.¹

¹ A more detailed account of refunding may be found in an article by Mr. Worthington Ford, in Lalor's "Cyclopaedia of Political Science," also in Bolles's "Financial History of the United States," 1861-1885, pp. 305-341.

Table showing the changes in the National Debt since 1870.

DATE.	Six-per-cent bonds.	Five-per-cent bonds.	Four-and-a-half-per-cent bonds.	Four-per-cent bonds.	Total.
July 1, 1870	\$1,764,932,800	\$221,589,300	.....	.....	\$1,986,521,600
July 1, 1871	1,618,327,300	274,236,450	.....	.....	1,888,133,750
July 1, 1872	1,874,858,800	414,567,800	.....	.....	1,780,451,100
July 1, 1873	1,981,258,650	414,567,800	.....	.....	1,695,805,950
July 1, 1874	1,213,684,700	510,628,050	.....	.....	1,734,252,750
July 1, 1875	1,100,865,550	607,132,750	.....	.....	1,707,998,300
July 1, 1876	954,999,650	711,655,800	.....	.....	1,696,653,450
July 1, 1877	854,631,850	703,266,650	\$140,000,000	.....	1,636,588,500
July 1, 1878	788,619,000	703,266,650	240,000,000	\$95,850,000	1,750,735,650
July 1, 1879	310,952,500	646,905,500	250,000,000	679,878,110	1,887,716,110
July 1, 1880	255,750,400	484,864,900	250,000,000	739,347,500	1,709,998,100
July 1, 1881	196,875,600	439,841,850	250,000,000	739,347,500	1,625,567,750
Continued at 8½ per cent.	Continued at 8½ per cent.	.....	.....	.....	.....
	88,957,150	401,593,900	250,000,000	739,347,500	1,449,810,400
		82,082,600	250,000,000	737,949,300	1,324,229,150
July 1, 1882 . . . . .	.....	304,204,350	.....	.....	.....
July 1, 1883 . . . . .	.....	234,612,150	250,000,000	737,661,700	1,212,275,850
July 1, 1884 . . . . .	.....	194,190,500	250,000,000	737,719,850	1,181,910,850
July 1, 1885 . . . . .	.....	194,190,500	250,000,000	737,740,350	1,181,980,850
November 1, 1885 . . . . .	.....	194,190,500	250,000,000	737,779,900	1,058,984,150
December 1, 1886 . . . . .	.....	71,154,250	250,000,000	737,779,900	1,058,984,150

Pacific sixes amounting to \$64,622,512, the Navy pension fund, amounting to \$14,000,000 in three per cents, the interest upon which is applied to the payment of naval pensions exclusively, and \$228,800 of refunding certificates, are not included in the table.

But what may be said of the principles involved in the law, or suggested by the manner in which it was carried out? Most of the points have been already discussed, but there yet remain two or three questions that should claim attention.

Is it wise to guarantee bonds against State or Federal taxation? In discussing this question, men are too apt to dwell upon the special privileges granted the bondholding class in case this species of property is not taxed. Class exemption is certainly an injustice, but such a generality does not touch the point at issue. The question is one that has primarily to do with figures and balances. As the price of bonds rises, the rate of interest that must be paid falls. It is, therefore, of advantage that bonds be quoted at a high figure. But one of the most important elements in raising the price of obligations is clearness and certainty of contract. There must be no contingencies, no loop-holes, no reserved rights, no possibility that a change of public policy may affect the value of the property bought. Should a govern-

ment reserve the right to tax its own bonds, the uncertainty attaching to such property would depress its price. Such bonds would not sell unless the government offered a higher rate of interest than would otherwise float them at par. It is true the government retains an additional source of revenue—the tax on the bonds—but this is offset by the additional expenditure entailed by the increased interest-payments.

The question, therefore, reduces itself to this: Is the increment of revenue flowing from the tax likely to be more than the additional expenditure occasioned by retaining the right to tax the bonds? We, of course, assume that this right will not be so employed as to extinguish the value of public securities, but, on the basis of this assumption, there is little doubt as to the proper answer to the question. The current burden of a public debt is lightened by exempting securities from taxation, provided only the administration adopt the policy of frequent conversions. It may be said that the purchasers pay their tax in the enhanced price they pay for the bonds.

Another interesting point respecting conversion is suggested by the fact that the law of 1870 provided for three classes of bonds, each class bearing a different rate of interest, and granted different dates of maturity. This method of procedure is severely criticised by M. Leroy-Beaulieu, who commends by preference the method of conversion adopted in England. According to the English policy of conversion, the operation is addressed to the entire amount of a given class of obligations, and the conversion results in the establishment of uniform debt. This does not, however, quite bring the distinction between the two systems clearly before the mind.

The real point of difference turns on this question: Is it best to adopt a policy of frequent conversion, by means of which a small saving is effected, or a policy of few conversions with larger immediate gain as the result of the operation? If the policy first mentioned be the appropriate one,

it is certainly unwise to provide in the same law for the conversion from 6 per cent to 5 per cent, and also from 6 per cent to 4 per cent; for, if bonds of the former class are worth but par, those of the latter can only sell if purchasers are guaranteed a long enjoyment of that rate of interest. This question, which pertains to the proper length of guarantee against a new conversion, has received adequate attention, but it is here presented in a little different light.

Wherever a permanent debt is established, and there is no thought of quick payment of the principal, the plan of frequent conversions on small margins is defensible; for, in the course of a long run of years, this plan will grant the country greater relief. A country can afford to bear a slightly increased payment this year, in order that five years hence a five-per-mill conversion may be effected. But, if the debt is in rapid process of expungement, the same conclusion does not follow. It may be wise to effect a large immediate saving upon part of the debt, by granting a long guarantee, for the purpose of securing additional funds with which to carry on the policy of debt-payment upon the high-priced bonds.

It is true that, in the course of ten years, the government may find itself paying higher rates upon its outstanding bonds than the rate for which fresh money could be borrowed; but this is partly compensated by the fact that fewer bonds are outstanding, some of them having been extinguished by applying to their principal the amount saved through long-time conversion. This, as it appears to me, is the only defense of the American method of refunding as compared with the English. It is perfectly logical for M. Leroy-Beaulieu to approve frequent conversions at uniform rates, for he does not permit the question of paying the principal to modify his argument.

In considering the act of 1870, however, we are constrained to say that a little too much was taken for granted. It would have been much wiser for the statesmen of that day to have held a little closer to the facts as they knew

them, and not have bound the government to pay 4 per cent upon \$740,000,000 of bonds until 1907. These obligations are now selling at rates which show that a three-and-a-half-per-cent bond with the same guarantee could be successfully placed on the American market, and the excessive payments that must be maintained for twenty years are the source of greater loss to the country than the immediate saving upon the long-time bonds, however that saving might be applied. While, then, we may approve the general principle underlying the refunding act of 1870, we are obliged to criticise the manner in which it was applied.

A refunding operation, like the placement of a new debt, may be carried on through the agency of a syndicate of bankers, or by the direct management of the government. In the former case the business is farmed out. The bankers forming the syndicate agree to place the new bonds at their own expense, paying for printing, transfer, and exchange, in consideration for a stipulated commission. In the latter case the Secretary of the Treasury takes all risks and pays all expenses. During the late war, the usual appropriation for the placement of a new loan was one per cent, and, according to European experience, this was not regarded as an excessive rate. But it is reasonable to expect that the refunding of an existing debt in time of peace may be carried through at much less expense, and we are not surprised to notice that the appropriation allowed by the law of 1870 was reduced to one half of one per cent. But is it wise to employ a syndicate, or should the government be its own agent? This question does not turn, as many seem to suppose, on the desirability of concentrated or diffused loans. The original method adopted for the sale of bonds exerts little influence upon their final residence when once thrown upon the market.

The point at issue is partly one of administration, but pertains primarily to the relative economy of the two methods. And it is fortunate that we are not left to speculation in deciding the question. Previous to the summer of 1877, all operations in refunding were carried on by syndicates,

the commission allowed being the total amount appropriated by the law to cover the expense of conversion. Secretaries Boutwell, Richardson, and Bristow sold \$500,000,000 of five-per-cent bonds at a cost to the government of \$2,500,000. Secretary Morrill also made a contract for the placement of \$300,000,000 of four-per-cent bonds upon the same terms, of which \$198,000,000 were sold at a cost of \$925,000. But when Secretary Sherman took the treasury portfolio, the plan of placing bonds by syndicates was abandoned for sale upon public advertisements, or, as it was termed, "under circulars." This plan was followed for the entire amount of four-per-cent bonds, with the exception of about \$15,000,000 which were secured on a foreign contract. The resumption bonds were also sold through a syndicate, but with these two exceptions Mr. Sherman himself managed the sales for the Treasury. The method of procedure was quite simple. The Secretary issued a circular descriptive of the new bonds and stated the terms on which subscriptions would be received. All subscriptions were to be accompanied with 2 per cent of the purchase money, the remainder to be paid within thirty days, at the pleasure of the subscriber, but upon such payments interest was allowed at the rate of 4 per cent. A commission, also, of one eighth of one per cent was allowed on all subscriptions over \$1,000. Under this circular, which was dated January 16, 1878, about \$125,000,000 of bonds were sold. Upon January 1, 1879, a new circular was issued, which changed slightly the proposals of the Secretary, the most important modification being that the commission increased with the size of the subscriptions. One eighth of one per cent was allowed on all subscriptions under \$1,000,000, one fourth of one per cent on all subscriptions over \$1,000,000 and not exceeding \$10,000,000, and for offers beyond that figure an additional one tenth of one per cent was granted. "My object," says the Secretary, "was to get a strong competition between the great banks that were then competing," but the plan gave rise to discontent, and was soon abandoned for a uniform commission of one eighth of one per cent.

Another dodge to secure quick sales may be noticed in passing. It was provided that those bonds last subscribed should be first paid. The loan being of such a sort that length of investment is an advantage to the purchaser, it was hoped that this stipulation would induce a ready sale for the first bonds placed on the market. The importance of such a provision will be recognized when it is noticed that the difficulty of placing a new loan is always at the start; after a loan is well advertised it will ruin itself.

The success of the policy of sale by circulars may be seen from the following facts: The total sale of four-per-cent bonds amounted to \$740,847,800.00; the cost of this sale according to the plan followed by the other Secretaries would have been \$3,704,239.00, by the method adopted by Mr. Sherman it was effected at a cost of \$2,645,802.60.¹ And, as illustrative of the statement made above that the difficulty of a loan is at the start, it appears that this saving

¹ "Interview between the Finance Committee of the Senate and the Secretary of the Treasury," 1881, p. 19. The expense of this operation by items may be interesting:

<i>Statement showing the expenses of issuing the four-per-cent consols of 1907.</i>	
Commissions paid to the syndicate.....	\$386,369 68
Commissions paid under the circulars.....	1,568,528 28
Extra force employed.....	190,638 82
Extra compensation paid.....	9,968 55
Engraving plates and printing bonds and certificates.....	308,465 38
Transportation by express, messengers, etc.....	168,381 29
Incidental expenses	23,460 60
Total amount expended.....	\$2,645,802 60
 Total amount of subscriptions to the four-per-cent consols of 1907, to date.....	\$697,989,550 00
Amount exchanged for 5-20's and 10-40's.....	2,895,500 00
Amount of refunding certificates sold.....	40,012,750 00
 Total.....	\$740,847,800 00
One half of one per cent appropriation on the above amount.	\$3,704,239 00
Amount expended from this fund.....	2,645,802 60
 Remaining unexpended.....	\$1,058,436 40

of \$1,058,436.40 was made on the sale of the last \$300,000,-000 of bonds. The teaching of this experiment is in harmony with the views presented in this essay throughout, that in matters of administration it is wise for the government to keep itself independent of the agencies of banks. Popular enthusiasm brings banking support, but banking enthusiasm can not arouse popular interest. It may be said that the amount saved from the appropriation is not of much importance to the government, and that is true so far as the money is concerned; but it is certainly worth something to the credit of the government that the cost of its financial operations is less than the cost regarded as necessary by European peoples. It is these little things, showing administrative ability, that make up the financial standing of a state.

The peace management of public debts as a financial question is not difficult to understand, though it brings to view many points of intricate detail. The conclusions to which our study respecting it seem to point are as follows. The financier should at all times have a just regard to the needs of investors in giving shape to the public debt; he should be well versed in commercial relations so as to render wisely such assistance as lies within his power in time of commercial pressure; he should endeavor to maintain harmony at all times between the form of the debt and the various laws dependent upon it for their successful working; and above all he should have clear views respecting the policy of conversion. Our study upon conversion, also, has led us to perceive that no possible argument can lie against it as a policy; that the first step toward the realization of the benefits it affords is the establishment of public credit; that a refunding law should not be so drawn as to embarrass the policy of debt-payment or prevent additional savings by future conversions; and that the same considerations which demand that bonds shall in the first instance be issued at par call for par conversions. The refunding act of 1870 may on the whole be approved. Bonds should be exempt from tax-

ation, but it seems that an unnecessary privilege was granted public creditors in the issue of a four-per-cent bond to run for thirty years. So far as the details of the operation are concerned, the experience of the United States leads to the approval of refunding under the advertisement of treasury circulars, rather than by means of syndicates.

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CHAPTER V.

PAYMENT OF PUBLIC DEBTS.

THE final topic in connection with national deficit financing pertains to the policy and method of debt-payment. Is it wise for a people to endeavor to expunge a public debt? If so, at what time should the policy of payment properly begin? At what rate should payment be carried on when once begun? What plan for the expungement of public obligations is most in harmony with sound principles of finance? Such are the questions claiming our attention in the present chapter.

Does sound policy demand the payment of a Public Debt?

The policy adopted by the United States with regard to the expungement of its obligations is not of wide acceptance. From the time that Gallatin assumed control of the Federal Treasury to the present, the American people have manifested a strong dislike to the perpetuation of a funded debt, but in other countries this sentiment fails to find response. It is true that England and Holland appear to appreciate the arguments for the extinction of public obligations; but the Latin peoples, whether in Europe or in South America, as well as those peoples of Eastern and Asiatic civilization who have come in contact with and imitate European manners, do not attach much importance to the necessity of reducing the principal of their debts. It thus appears that the advisability of debt-payment admits of serious discussion.

Yet it should be clearly discerned at the beginning that

this discussion does not turn upon a question of principle, but has wholly to do with methods of procedure. It is now universally admitted that a debt can only be paid out of surplus revenue, and all financiers readily accede to the proposition that financial burdens at any time imposed upon the industries of a country should be as light as possible. The real point in controversy pertains to the best way of attaining this end, a statement that may be easily understood if we consider for a moment the elements that go to make up the burden of a debt.

The constituent elements of this burden are the principal of the debt, or the amount to be paid; the annuity occasioned by the debt, or the annual interest demanded; and the industrial condition of the country, or the underpinning of the debt. This factor last mentioned should receive due recognition, since the argument in favor of perpetual indebtedness rests upon an overestimation of its importance; and it must be conceded that the true conception of a burden of any sort brings to mind not merely the weight carried, but compares that weight with the strength of him who carries it. It is at this point that the two schools of finance part company. The one would reduce the burden of the debt by extinguishing its principal, the other would accomplish the same purpose by developing national resources.

There are two classic arguments put forth by those who defend the policy of perpetual indebtedness. It is claimed, in the first place, that the pressure of a public debt is necessarily decreased from year to year by the gradual depreciation in the value of the monetary unit in which all obligations are expressed; this depreciation being the result of constant additions made to the amount of money material, and of continued development of the mechanisms of exchange.¹ This

¹ "The most remarkable effect of the depreciation of gold is a considerable reduction of the national debt. The national debt of this country (England) was in 1860 represented by a capital of £819,079,805. The annual charge was then £26,176,275. A gold depreciation of 9 per cent, which is quite the least I can believe to have occurred, must therefore have effected a reduction in the

argument, however, does not call for extended consideration. The fact which it states as a general fact, taking into view the variations of the precious metals from century to century, can not be denied, although there is some reason for believing that the tendency of gold to fall in value has, at the present time, received a temporary check. But without relying upon such a suggestion for our decision, it certainly seems that gradual depreciation is too tardy in its workings to be worthy serious consideration. Before the burden of a debt, like that, for example, which the United States is bearing, could be sensibly diminished through depreciation in the value of the monetary unit, an addition of a tenth of one per cent to the annual interest payments would have extinguished the principal.

The second argument for perpetual indebtedness is worthy more serious consideration. Why, it is asked, should a people bear a high rate of taxation for the purpose of reducing the principal of a debt, when all the practical effects of debt-reduction may be realized through the natural growth and prosperity of the nation ?¹ A wise policy, it is claimed, demands that the entire energy of the country be given to the development of industries, and to the increase of wealth and numbers ; since the financial ability of the country may in this manner be so greatly enhanced that the pressure of the debt will cease to be felt. The experience of England is often cited in support of this view. The pressure of her debt in 1815 is computed as equivalent to 9 per cent of her

capital of about £75,000,000, and in the annual charge of nearly £2,500,000." —Prof. Jevons, in "A Serious Fall in the Value of Gold," pp. 57, 58. This was published in 1863.

¹ Qu'avaient besoin les États-Unis d'amortir le capital de leur dette consolidée ? Le poids de celle-ci diminuait tous les jours par la réduction du taux de l'intérêt, par le développement de la richesse publique, par l'arrivée des immigrants, par l'augmentation de la population. Une dette, qui était assez lourde pour 35 millions d'habitants, serait devenue bientôt insignifiante pour un pays de 80 à 100 millions d'âmes, ayant un territoire presque illimité. Les États-Unis ont donc fait un grand sacrifice pour un bien mince résultat." —Paul Leroy-Beaulieu, "Traité de la Science des Finances," ii, pp. 446, 447.

yearly income ; in 1880 it was observed to be less than 3 per cent ; but this reduction had been effected not by the expungement of her obligations but by the growth of national wealth. The actual result, so far as debt-burden is concerned, is the same as though two thirds of the principal had been paid while the amount of her wealth remained stationary. In France, also, one may discover the working of the same principle, although in this instance the pressure of the debt remained constant, or is increased very slightly, while the capital sum of her obligations has greatly increased. Thus the capitalized sum of the French debt was in 1840 \$850,000,000, in 1870 it was \$2,750,000,000 ; but the pressure of the annual payments demanded by these debts, computed upon national income for the respective periods, is found to be .022 and .023.¹ That is to say, the national income of France increased at a rate nearly as rapid as that of her debt, notwithstanding the extravagances of the first empire. But it should, perhaps, be added, that this favorable exhibit has been destroyed by the financial disasters occasioned by the Franco-Prussian war.

It is upon such facts as these that the common argument in support of the policy of perpetual indebtedness is based, and, so far as the facts are concerned, there is no room for controversy. But the conclusion of the argument may not so readily be accepted, for, if it can be shown that the payment of the principal of a debt has no tendency to retard the industrial development of a nation, the entire course of reasoning falls to the ground. As opposed to the idea from which this reasoning must proceed, I venture to place the following proposition, which, if maintained, will furnish an incontrovertible argument in favor of the policy which the United States has adopted :

The payment of the principal of a debt tends neither to impoverish a nation nor to retard its material development ;

¹ Cf. "National Debts," by R. Dudley Baxter, p. 55 ; and "Fenn on the Funds," p. 436.

but, on the other hand, the maintenance of the principal and the constant payment of accruing interest tend to cripple the productive capacity of any people.

The two parts of this proposition should receive separate attention, and we are led first to inquire if the industries of a country are injuriously affected by the process of payment. It is admitted by all that somewhere in the course of deficit financing—either at the time the debt was established, or during the period that it was carried, or at the date of its payment—a loss is sustained chargeable to the adoption of the loan policy. Should one reason from the analogy of private debts, he will conclude that this burden is borne at the time when the debt is paid; for when an individual debtor clears himself from obligations, he loses control over a certain amount of capital, and consequently lessens his importance as a member of industrial society. But such reasoning can not be applied to the state. The state is not an individual, it has no life separate from the united lives of all citizens, and it recognizes no interest but the collective interest of society. The state is the corporate representative of all citizens, creditors as well as debtors, and is not at all interested in the proprietary residence of capital, provided only it be judiciously employed. Since, then, the payment of its own obligations effects no more than a transfer of control over capital from one set of men to another, it can not be said that the industrial development of the country is thereby obstructed.

The position here assumed may be easily understood if one hold firmly in mind the nature of capital. Capital is subsistence fund, and he who controls it has it in his power to direct labor. It is capital which the state wants when it borrows money, and in borrowing capital it draws to its own use that which, had it not been thus appropriated, might have been applied to some productive industry under private management. The obligations which the state creates against itself are written in the language of money, because this is the most convenient language known for the expression of

indebtedness ; but the state has no use for money except to effect the transfer to itself of control over existing capital.

Suppose a state to borrow a billion dollars ; it can not be said that industrial society is thereby necessarily rendered any the poorer. Capital is not destroyed by the borrowing. Before the loan was filled, the nation was possessor of a certain amount of capital, distributed in a thousand funds and under the direction of a thousand wills ; after the loan the nation as a whole holds the same amount of capital as before, the only difference being that control over it has passed to the state. Whether or not this operation is industrially detrimental depends upon the use to which the state puts the proceeds of its loan. If this be consumed in the prosecution of a war, the nation is impoverished to the extent of the unproductive consumption, since capital, in the form of bacon, flour, clothes, implements, mules, and the like, has been destroyed. We may, then, conclude that the injury sustained on account of a loan for war purposes is sustained at the time the loan was contracted, and is due to the fact that the state has caused a certain amount of capital to disappear without hope of recovery.

Let us now turn to the process of payment. The obligations which the state has created against itself call for the payment of a certain amount of money. The money, which it obtains by means of taxation, is held for a moment, then transferred to the public creditors, and in this manner the state becomes absolved from its indebtedness. It would of course be incorrect to say that this transfer of money from one set of citizens to another does not in the least disturb capital, for possession of money is the evidence of ownership in capital ; but it may be rightly claimed that it does not destroy capital. Before the payment, one set of individuals controlled the subsistence fund of the country to the extent of the payment ; after the extinction of the debt, ownership rests with another set of individuals. The government is freed from the necessity of providing an annual sum in the form of interest, and, measured by the amount of capital in

the country, the nation is in no wise impoverished. There is the same amount of food for the subsistence of laborers, and the same amount of raw stuffs upon which to set them at work. If the new masters of capital are as enterprising as the old, the nation loses nothing by the payment of its debt. This is the explanation, and in the explanation lies the defense of the proposition that the payment of a public debt does not necessarily impoverish a nation. The injury to industrial society is worked by the destruction of capital at the time the loan was contracted ; the labor required to create again the capital thus destroyed constitutes the burden imposed upon the nation ; the payment of the principal of the debt is at most but a re-adjustment of ownership in existing capital. It is a fallacy to argue that the expungement of public obligations destroys capital.

But how is a people impoverished by the maintenance of the principal of a debt ? In so far as bondholders live from the proceeds of their bonds, they form a class not immediately interested in current industries. At some time in the past they may have furnished the government with large sums of capital, thus averting the inconvenience of excessive taxation or of a sudden change in rates ; and, in return for this service, they received from the government the promise of an annuity until an equivalent of the original capital should be returned. Such persons are guaranteed a living without labor.

There is but one way in which the government may escape the necessity of supporting in idleness this class, and that is by paying its members their respective claims. The bondholders would in this manner be deprived of their secured annuity, but they would in its stead hold a sum of free capital ; and if they wish to continue in the enjoyment of an income from their property they must apply their funds to some productive purpose. In this manner the country gains by bringing to bear upon industrial affairs the interested attention of those who formerly were secured a living from the proceeds of public taxes. For another reason

also is the payment of a debt advantageous. No people can long retain that hopefulness so essential to the vigorous prosecution of industries if the past lays heavy claims upon the present. As a rule, they only should partake of current product who are in some way connected with present production. Carelessness and jealousy are not characteristics of efficient labor, but they are sentiments naturally engendered by the payment of taxes for the support of a favored class. It is the permanency of this payment, rather than its amount, which exerts a depressing influence upon labor, and its extinction is a first step toward the establishment of confidence and contentment. It is for such reasons as these that we conclude that the policy of debt-payment vigorously prosecuted will assist rather than retard industrial development.

With what Rapidity should the Policy of Debt-payment proceed?

It is not difficult to determine the principle upon which an answer to this question rests. The course of reasoning to which the decision of the financier should conform is quite analogous to that already considered in connection with the feasibility of creating a public debt. As will be remembered, the only defense for the use of public credit as a source of revenue is that, in this manner, excessive taxes may be avoided; so with regard to the expungement of obligations, a policy of debt-payment should not be set on foot until all injurious taxes shall have been repealed, nor proceed so rapidly as to demand a high rate of taxation. This rule is so simple that its mere statement must gain for it general approval, but, as is usually the case with practical questions, the real difficulty lies in its application. It is a very delicate task to determine just at what point the benefits which arise from the expungement of a debt overbalance the inconvenience attending the taxes rendered necessary by the continuance of the policy. How may one attach a practical working interpretation to the phrase "injurious taxes"? What is the evidence of excessive demands for public purposes?

There is no inconsistency in admitting the possibility of excessive taxation for the extinction of a debt, and in holding at the same time that the process of debt-payment can not injuriously affect a people's industries. The one statement refers to the fact, the other to the process of payment. Our former argument proceeded as though the destruction of capital was the only contingency against which the financier should be on his guard, but such an assumption is incorrect. Capital is neither the only element nor the most important element to be held in view. It is a dead thing, and its possession goes no further than to show the possibility of industrial development. It is this fact which the financier should always hold in mind, and he should ever be on his guard against destroying the motive for applying capital. The chief mainspring of activity in industrial life is the hope of profit. Without the possibility of personal gain, our highly-developed industrial structure would be thrown to the ground. If this cardinal truth be firmly grasped, there will be little difficulty in properly interpreting the expression "injurious taxes."

It appears, then, that the rate of taxation should at no time be so excessive as to act like a dead weight on the spirit of enterprise. It would be suicidal for a government to push a policy of debt-payment with such vigor as to curtail in any marked degree the hope of personal gain, since in this manner it would destroy the fund out of which alone payment can be made. It is true that there is always a tendency in progressive societies for the rate of profit to fall, and that each succeeding generation will save and apply capital for a lower percentage return than the one which preceded it; but it is also true that in every community at a given time there is a normal rate below which, if profits fall, industries can not be maintained. It is the part of wise legislation to discover this limit, and to avoid any policy that will tend to force usual profits below it. This, then, is the answer to the question respecting the rapidity at which a public debt should be extinguished. Its expungement should

not proceed so rapidly that the taxes imposed will reduce profits below the normal working minimum.

But the practical question still remains. What is the rate of profit in the United States that sets a limit to the rapidity with which a public debt may be paid? For an appropriate reply to this question we must depend in large measure upon the past experience of the government, and to this end a rapid review of the management of the debt since the late war will be of direct assistance.

The interest-bearing obligations of the United States stood at their maximum in August, 1865, amounting at that date to \$2,381,000,000. If with this amount we compare the corresponding debt of January, 1887, it appears that obligations to the extent of \$1,252,000,000 have been extinguished, thus showing an annual rate of decrease of \$58,000,000. This does not, however, adequately represent the rapidity with which the policy of debt-payment has been carried on. The redemption of debt for the single year ending June, 1882, amounted to \$166,000,000, being \$121,000,000 in excess of the demands of the sinking fund. The average as above given is greatly reduced by the treasury operations of the years 1877 and 1878, which were addressed to preparation for the resumption of specie payments; for, in order to secure an adequate amount of specie to insure the success of that measure, it was found necessary to increase, temporarily, the total of bonded indebtedness. But this measure itself should be regarded as a step in the reduction of the national debt, for by an accumulation of specie reserve the legal-tender notes were practically paid, while the amount outstanding has been reduced from \$428,000,000, in 1865, to \$346,000,000, in 1887. In addition to these transactions, also, \$26,000,000 of fractional currency has been withdrawn, and its place filled with metallic currency. All these operations must be taken into the account to properly represent the extent of the payment of public obligations since the close of the war.

Possibly these results of fiscal administration may be more

easily grasped if reduced to a per capita basis. In 1865 the per capita debt of the United States, that is the total debt less cash in the treasury, was \$78.25 ; in 1880 it amounted to \$37.74 ; at the present time it is \$28.80. In 1865 the per capita interest annually charged on account of the debt was \$4.29 ; in 1880 it had fallen to \$1.56 ; at the present time it is less than \$0.90.

When by the side of such a record of debt-payment we place the general material prosperity of this country since 1865, there is a strong presumption, to say the least, that the rate of payment has not rendered necessary excessive taxation nor forced profits below the working minimum. The paying capacity of the American people is enormous. The expungement of the total interest-bearing debt would require but 13 per cent of the annual gross product of the country. Were it for any reason necessary, the people of the United States could easily support an annual debt-payment of \$200,000,000, which would be a sum equal to 2 per cent of the annual product, or about one quarter of the total public expenditure for Federal, State, and local purposes. It seems, then, that the current demands of the sinking-fund, which approximate \$50,000,000 for each year, is not excessive, and can have no tendency to check the prosperity of the people.

This question may be approached from another point of view. Profit, stripped of its technical meaning, implies the excess of what is produced over the cost of its production. The rate of national profit, therefore, upon a year's industry will be represented by the increased valuation of real and personal property. Accepting this idea as the basis of computation, we find the average rate of profit in the United States for years of peace to vary from 7 to 8.5 per cent. From calculations upon the basis of 7 per cent as normal profit in the United States, it may be discovered that the annual payment of \$50,000,000 to the sinking-fund imposes a reduction in the rate of business profits of but seven tenths of a mill. As compared, then, with the actual profits, the margin of variation imposed by the policy of debt-payment is so

slight that we can not regard it of much importance. It will not deter men from undertaking new business enterprises. Or, if we compare the rate of profit enjoyed in this country, notwithstanding the taxes for debt-payment, with the rates in those countries to which capital and labor might emigrate, we must conclude that a wide margin remains before profits will be reduced below the working minimum. But I do not wish to be held too closely to the exact accuracy of these calculations.

Concerning the best Method for paying Public Debts.

Assuming, then, that public obligations should be paid as rapidly as the industrial condition of a people will allow, we are led next to inquire respecting the most appropriate method of procedure. It seems needless to enter upon an extended consideration of the principles underlying the old sinking-fund payments. Those calculations of Dr. Price, which were embodied in fiscal legislation by Mr. Pitt, and afterward shown to be wholly fallacious by Professor Hamilton, are familiar to all who have given the slightest attention to financial subjects; nor should I refer to them at this time, were it not that they are intimately connected with the question of terminable and life annuities as a means of extinguishing a public debt. Such a connection was recognized by Dr. Price himself. It is sometimes erroneously supposed that this close student of "political arithmetic" looked with favor upon a public debt, and that he invented the scheme of sinking-funds in order to trick the people into maintaining public obligations. Nothing could be further from the truth. His remarkable essay upon "Public Credit and National Debts" is introduced by language which severely deprecates the growth of such incumbrances. After speaking of the rise of debt since the Revolution, he says:

One can not reflect on this without terror. No resources can be sufficient to support a kingdom long in such a course. 'Tis obvious that the consequence of accumulating debts so rapidly, and of mortgaging posterity, and funding for eternity,

in order to pay the interest on them, must, in the end, prove destructive. Rather than go on in this way, it is absolutely necessary that no money should be borrowed, except on annuities, which are to terminate within a given period.¹

But the essayist does not grant an unqualified approval to terminable annuities.

I am [he adds] far from intending to recommend this plan as the best a state can pursue. There is another method of gaining the same end, which is, on many accounts, preferable to it. I mean "by providing an annual saving, to be applied invariably, together with the interest of all the sums redeemed by it, to the purpose of discharging the public debts : Or, in other words, by the establishment of a permanent SINKING-FUND."²

What, then, is a sinking-fund as understood by Dr. Price and established by Mr. Pitt? This piece of fiscal machinery consisted in the annual appropriation of a certain sum of money to the purchase of public stocks at their current price, and the application of the interest accruing upon stock so purchased to yet further increase the operations of the fund. If only these two appropriations be maintained, a debt of any magnitude is sure to be discharged. The original payment may in the first instance be small, but since all moneys applied to the purchase of stock accumulates at compound interest after that purchase, it will in time amount to any conceivable figure. As Professor Hamilton remarks, "the work is written in a very intemperate style." The efficacy of the fund was made to rest upon the *inviolability of the annual appropriations*,³ and it was regarded as essential that the annual purchases should be continued, even though it became necessary to borrow money for that purpose at a higher

¹ "Observations on Revisionary Payments," by Richard Price, D. D., F. R. S., vol. i, pp. 273, 274.

² *Ibid.*, p. 276.

³ "What has been said, has all along supposed a *sacred* and *inviolable* application of the fund I have described, and of all its earnings, to the purpose of sinking the national debt. The whole effect of it depends on its being allowed to operate, *WITHOUT INTERRUPTION*, a proper time."—P. 295.

rate of interest than that borne by the funds redeemed.¹ It was conceived that war would increase the efficiency of the fund, because, the rate of interest being high, the fund was at that time making the quickest progress. Nor did Dr. Price regard the conversion of debt into bonds bearing a low rate of interest as desirable, should the amount saved be applied to the remission of taxes rather than to the increase of the sinking-fund appropriations.²

The germ of truth contained in this curious essay is, that an annual appropriation, however small, will in time pay a debt of any magnitude; and, provided sums equal to the interest upon the debt extinguished be also devoted to debt-payment, the expungement will proceed with continually accelerating rapidity. But it should be held in mind that all appropriations must be from clear revenue, or the new debt created in order that payments may continue will equal the debt expunged. A thousand calculations could not bring this truth into clearer light than its simple statement. The reasoning of Dr. Price proceeded upon the erroneous theory that when a government buys its own stocks it purchases a

¹ "It is an observation that deserves particular attention here, that on this plan it will be of less importance to a state what interest it is obliged to give for money; for, the higher the interest, the sooner will such a fund pay off the principal."—Pp. 277, 278.

"For by employing the SINKING-FUND in bearing current expenses, rather than borrowing *new* money on new funds, the state, in order to avoid giving *simple interest* for money, is made to alienate money, that *must* have otherwise improved at *compound interest*; and which, in time, would have *necessarily* increased to *any sum*."—P. 297.

"Money in a *sinking-fund*, if never alienated, is improved at compound interest; but when procured by a loan, bears only simple interest."—P. 314.

"The general idea of converting the *three per cents* into a fund bearing a higher rate of interest, with a view to facilitate redemption, you have on many occasions suggested."—From a letter of January 8, 1786, from Mr. Pitt to Dr. Price, in which he asks for suggestions respecting his proposed sinking-fund.

² "It follows from hence that reductions of interest would, on this plan, be no great advantage to the state. They would indeed lighten its *present* burdens; but this advantage would be in some measure balanced by the addition which would be made to its *future* burdens, in consequence of the longer time during which it would be necessary to bear them."—P. 279.

productive property. He could not otherwise have spoken of the "earnings" of the fund. But that can not be regarded as a productive property to the government which rests upon taxes levied and collected by the government. It is the taxes that are the source of revenue and not the fund. It must also be regarded as a mistake to speak of borrowing money at simple and investing it at compound interest when a government borrows money to buy its own stock. For a given amount of clear revenue devoted to the service of the debt, a country will not emerge from its indebtedness any the quicker because of such an arrangement. It seems that Dr. Price, being an adept at political arithmetic, was led astray by his computations in compound interest.¹ He did not recognize that the source of all interest is current product, and that "earnings" is a word which can only apply to an established business. Nor did he see, any more clearly than many of his critics have seen, that compound interest is merely a calculation, and finds no corresponding fact in the order of production.

The theory of maintaining an inviolable sinking-fund was formally abandoned by English statesmen in 1829, by an act which declared that only surplus revenue should be applied to the reduction of the public debt. One can not, however, say that false views of debt-payment disappeared with the enactment of this rule, for the policy of converting public stock into terminable annuities as a means of debt-extinction still prevails. This policy was introduced in 1808, by the Right Honorable Spencer Perceval, at a time when the principles of Mr. Pitt's sinking fund of 1776 were in full favor.

¹ The supplement to this essay concludes with saying: "One penny put out at our Saviour's birth to five *per cent* compound interest would, in the year 1791, have increased to a greater sum than would be contained in THREE HUNDRED MILLIONS of earths, all solid gold. But, if put out to simple interest, it would in the same time have amounted to no more than SEVEN SHILLINGS AND SIX PENCE. All governments that alienate *funds* destined for re-imbursement, choose to improve money in the *last* rather than the *first* of these ways."
—Pp. 314, 315.

* 10 Geo. IV, ch. 27.

It provided for an exchange of three-per-cent stock into equivalent annuities for the life of the holder, and was regarded by its projector, as indeed it was in reality, as an ancillary part of the sinking-fund administration.

But, though thus connected, the policy did not share the fate of the old sinking-fund, for, in 1829, parliament reaffirmed its confidence in terminable annuities by the passage of an elaborate act for their creation. It was thought that adequate provision had in this manner been made for the discharge of public obligations, and subsequent legislation declares that English opinion has not retreated from the position then assumed.

The theory according to which an annuity is drawn is not difficult to understand. It is in form a promise to pay, let us say annually, a definite sum of money for a specified length of time. If the annuity be "certain," the year at which payment shall cease is stated in the contract; if it be a life annuity, the payment continues until the death of the annuitant.

The theory of the annuity certain is a simple application of algebra to the fundamental idea of compound interest. According to this idea, any sum of money invested, or put at interest, is increased at the end of the year by the addition to it of interest at a certain rate; and, at the end of the second year, the interest of the first as well as the original sum is increased in the same proportion, and so on to the end of the last year—the interest being, in technical language, converted into principal yearly.³

In the case of terminable annuities, it is conceived that the annual payment computed on the sum of money originally borrowed exceeds the amount of simple interest at the ordinary rate, and this excess is charged to the reimbursement of the principal. It is this excess payment upon which compound interest is computed, and when, being compounded at the ordinary rate of interest, it amounts to the principal originally borrowed, the debt is said to be discharged. Thus

¹ 10 Geo. IV, ch. 24.

² "Encyclopædia Britannica," ninth edition.

the date at which the annuity falls in is determined by the rapidity at which the excess payment accumulates ; and this, for any given payment, varies directly as the rate at which it is calculated. Thus, a perpetual annuity, when interest is 5 per cent, is said to be worth twenty years' purchase, or an amount equal to twenty times any single payment. The price for one hundred years is nineteen and eight-tenths years' purchase, and for any number of years less than one hundred it is worth whatever sum, at the accepted rate of computation, the annual payment will amount to. At 4 per cent, the value of a perpetual annuity is twenty-five years' purchase ; at 3 per cent, it is thirty-three and one third years' purchase.

It seems, then, easy to understand how a debt may be discharged by converting stock into terminable annuities. Holders of stock will lose nothing provided only the annual payment on account of the debt be increased beyond the sum accruing at simple interest. Upon the plan of a sinking-fund, this surplus revenue would be accumulated in the hands of commissioners until it had absorbed the entire debt ; according to the annuity plan, the accumulation is calculated and the amounts are paid directly to the creditor in installments. Setting aside the question of expense and the danger of miscalculations, a given surplus, inviolably maintained, will discharge a given debt with equal rapidity in whichever way it be applied.

Wherein, then, lies the difference between terminable annuities and sinking-funds as a means of discharging a debt ? This difference pertains wholly to the form of the contract. In case of annuities, the parties to the contract are the government on the one hand, and public creditors on the other, from which it follows that a failure to make payment as promised would be confession of public bankruptcy ; in case of a sinking-fund, however, the promise of payment is from the government as a whole to the Sinking-Fund Commissioners, who are themselves officers of the government ; and should the appropriations to the service of the debt be used

in some other manner, there is no one to make complaint. The failure of sinking-funds to extinguish debt is due to the fact that governments continually borrow from the fund to meet pressing emergencies, which means that moneys appropriated to the service of debt are diverted to other purposes. But by the arrangement of an annuity no such borrowing is possible. The annual payment on account of principal forms part of the contract. New demands must be met by new taxes or by fresh loans upon the market. It is, then, correct to conclude that terminable annuities are merely a mechanical contrivance for the purpose of rendering the principle of the sinking-fund automatic in its action. They can not, therefore, meet the approval of sound finance, for they involve the error of proceeding at all hazards with the payment of one debt, even while another is being contracted.

But if annuities are merely disguised sinking-funds, why have English financiers maintained them as a means of debt-payment? There seem to have been two reasons for this. The English debt was originally issued at discount, but has since gradually and persistently risen in price. Under such conditions the conversion of discount-stock into terminable annuities permits the government to reap the advantage of expunging its stock at the price which ruled when the conversion took place. This was Mr. Perceval's idea, whose scheme of 1808 has been referred to, and his reasoning is tenable, provided the conversion takes place at the natural ratio between stock and annuities.¹ For purpose of illus-

¹ "The committee must be perfectly aware," said Mr. Perceval, "that the operation of the sinking-fund has recently very much increased the price of stocks. There is every reason to believe that by the continuance of that operation they will still further be increased in price. No one can doubt, Sir, that if the measure were consistent with public faith, it would be extremely desirable to give to the nation an opportunity of redeeming the whole of the national debt at the price of the stock, because that would preclude the effect which any further advance in the price of the stocks must have in retarding the operation of the sinking-fund. There are two objects which the sinking-fund has in view, the one to provide for the final redemption of the national debt, the other to keep up the price of stocks in the market, so as to enable government, when-

tration, suppose three-per-cent stock quoted at 60 per cent of its par value. This would show a \$1,000 bond to be worth \$600, and the ruling rate for money 5 per cent. Suppose, also, the government to convert this stock into a terminable annuity, by raising the annual payment from \$30 to \$60. One half of this payment will be charged to the payment of the interest, the other half to the extinction of the debt, and must continue until at 5 per cent compound interest it accumulate the sum of \$600. That is to say, it must continue between fourteen and fifteen years. Suppose, in the third place, that, at the time the annuity falls in, three-per-cent stock is quoted at 80 instead of 60, is it not plain that the government has saved the difference by entering into a contract to expunge its obligations when they stood at the lower figure? Had this annual payment of \$30 been accumulated in a sinking-fund, the extinction of the original debt would have required its continuance until \$800 had been accumulated. If a government, then, is so unfortunate as to have incurred its debt at discount, and is able to convert stock into terminable annuities at its arithmetic value, there is adequate apology for such an operation.

But can a government reasonably expect conversion to take place at the arithmetic ratio between stock and annuities? If the annuities created be for the life of the holder, it is probable that the conversion of a limited amount will take place at figures which do not entail loss to the public; for there is always a small class of persons to whom investments that give a sure income during life are very attractive.

ever the exigencies of the state may require it, to make an advantageous loan for the public. These objects, however, Sir, are in some degree inconsistent. In some degree they counteract each other. Whatever measure raises the funds, and thus enables government to borrow on the best terms, prevents the Commissioners for the Reduction of the National Debt from reducing that debt on the best terms. Now, Sir, the measure which I propose will combine both of these objects; it will naturally tend to increase the price of stocks, and it will, at the same time, secure the redemption, at a low price, of so much stock as may be transferred antecedent to the rise produced." (As quoted by Mr. Hendricks in "Journal of the Statistical Society of London" for 1856.)

But even with this class there is a danger of miscalculation if the government make use of ordinary life-tables ; for those to whom life-annuities are most attractive, being persons who desire to avoid the care and worry of ordinary pursuits, will prove unfortunate exceptions to the usual rule of vital statistics. But the amount of annuities that can be thus absorbed is limited, and if the government issue such a quantity as to force it into the hands of speculators, it can not expect satisfactory terms of conversion. It was a mistake on the part of Mr. Perceval to endeavor to throw such a large part of the public debt into the form of life-annuities. Not only did the government sustain serious loss by reason of the errors in the life-tables employed, as was declared by an investigating committee in 1828, but the large number of life-annuities created depressed their price. We can not then regard the conversion of discount stock into life-annuities as desirable for any considerable amount of debt. There is more to be said for the plan if the annuities employed are simple terminable annuities, but in this case the advantage reaped is not as great as one might expect ; for one who takes an annuity as a business investment will consider the repayment of the principal of the debt, and will demand such an amount in payment as will balance the probable future rise in the stock relinquished.

But parliament did not in 1828 abandon the policy of life-annuities. The scheme introduced by Mr. Goulburn, which became law the following year, conformed in its main features to the law of 1808 ; the table of vital statistics, however, upon which it was based, was radically modified. Mr. Goulburn stated :

That his only object was to extend the principle laid down in the former act, repealed in the preceding session, and to establish a more accurate basis for calculating the value of annuities, in order to combine with the greatest possible convenience to that part of the public interested in the purchase of annuities security against loss on the part of those who granted them.

We are not at present concerned with learning the degree of success which attended the new estimates ; but it is

interesting to notice how the government, in its subsequent administration of the policy of paying a public debt through annuities, has been obliged to resort to unusual measures for the purpose of inducing holders of stock to submit to conversion. A number of acts have been passed for the purpose of bringing savings banks and provident societies "into immediate connection with the National Debt Office as feeders to the plan of deferred and immediate annuities," and resort has also been had to the questionable measure of providing for public life insurance as a means of assisting the financial policy of the government.¹

A second reason why England has favored annuities as a means of debt-payment is found in the influence of an erroneous principle of political economy. The impression is left by many writers that the supremacy of Mr. Pitt's views respecting the sufficiency of a sinking-fund is responsible for the permanency of the English debt. This does not appear to be true. The English debt has not been paid because the mercantile classes conceive their immediate interests to be against it. They believe that taxes remitted "will surely fructify in the pockets of the people," and it has been impossible for the government to maintain a surplus fund in the face of such a sentiment. One of the reasons why Mr. Sargent² defends sinking-funds is that appropriations may be maintained in this manner when it would be impossible to accomplish such a result with open payments, though how he can hold such an opinion, in view of the history of past funds, it is difficult to understand. This, however, is the defense of terminable annuities. In 1855, Sir G. C. Lewis attempted to create a sinking-fund. The plan was opposed by Mr. Gladstone, who had no confidence in the ability of the chancellor to maintain such a fund.

¹ Compare Acts: 3 William IV, ch. 141; 7 and 8 Victoria, ch. 83; 16 and 17 Victoria, ch. 45. For a critical examination of government life-annuities from 1808 to 1855, the student is referred to an excellent article by Frederick Hendricks, Esq., in the "Journal of the Statistical Society of London," 1856.

² "Apology for Sinking-Funds," by William Lucas Sargent, 1868.

"You may [he said] snatch a vote in its favor, but you can not bind future parliaments. You will find that demands for remission of taxation will crush your measure." On another occasion Mr. Gladstone is said to have remarked that "the nation would not consent to pay its debts openly; he believed that the nation would consent to pay it when it appeared in the form of annuities."¹

It seems, then, that this defense of annuities, which is the only argument in their favor when stocks have approached par, is but a confession of inability on the part of the government to administer the debt on sound principles; but statesmen delude themselves if they believe that the public is to be thus tricked into maintaining adequate payments. The source of the evil is the erroneous principle of political economy and taxation already pointed out, and until the leaders of opinion are willing to assert "that a good deal of what the tax-gatherer leaves in the pockets of the people is simply wasted,"² the finances of the nation will continue to be controlled by counting-house rules. For the United States, the question of annuities bears no present interest. Were her debt at par, instead of being at high premium, it might be that a small portion of it could be wisely converted into terminable life-annuities for the convenience of dependent persons who have funds to invest. But, taking things as they are, with a large amount of debt coming down to par in 1891, such a proposal need not be seriously considered.

What has been the policy of the United States in providing for the payment of her public debt? Should one judge by the language of those laws pertaining to this subject, he might infer the views of American statesmen to have been shaped according to the principles of "the good Dr. Price," as Franklin was pleased to call him. How far this impression is correct is one of the disputed points

¹ Quoted from Sargent, pp. 78 and 79.

² Robert Giffen, "Essays in Finance." First series, p. 274.

of financial history. Federalist historians have been quite strenuous in their endeavors to show that the Federalist administration was not influenced by a line of reasoning that has since proved to be erroneous.

Our sinking-fund [says Jonathan Elliot, who has given more attention to the details of this subject than any other writer] differed materially from that which was adopted in the early financial history of Great Britain, as it was not exclusively applied to the liquidation of a particular debt in existence. It was also unlike that of Mr. Pitt, as the amount of the capital appropriated was not fixed before 1802 ; and when the amount of the appropriation was known the payment of the interest and charges on the debt was, in common with the principal, to be discharged from that fund. . . . Properly speaking, the essential character of a sinking-fund was not to be found in the operation of that of the United States.¹

This seems to me to press the matter a little too far. It is certain that the writings of Dr. Price were well known and highly appreciated in this country, for in 1778 the Colonial Congress tendered to him an invitation to become a citizen of the United States, and to assist in regulating her financial affairs. It is also significant that Congress committed itself as early as 1782 to the formation of a sinking-fund that should be "inviolably appropriated to the payment of the principal of the said debt, and shall on no account be diverted to any other purpose." It is true nothing of the sort was done, and it is probable the chief purpose of the legislature was to strengthen the arguments of agents then in Europe endeavoring to raise money on foreign loans. The first provision for expunging public obligations, after the organization of the present Federal government, is found in the last clause of the refunding act, which set aside the proceeds of public lands "towards sinking or discharging the debts, for the payment whereof the United States are holden." This is quite in harmony with the idea that prevailed throughout the revolutionary struggle, and but fulfilled the

¹ "The Funding System of the United States and of Great Britain," by Jonathan Elliot, 1845. Ex. Doc., 1st session, 28th Congress, p. 406, note.

expectations of those States that had made cession of territory to the Federal government.

The sinking-fund was established by an act of August 12, 1790, and its provisions further extended by an act of May 8, 1792. The President of the Senate, the Chief Justice, the Secretary of State, the Secretary of the Treasury, and the Attorney General, for the time being, were appointed commissioners. These commissioners were empowered to purchase public stock, and to hold it as trustees of the government, applying the interest accruing upon such stock to further purchases. All this was wholly English. The money appropriated to set this fund in operation came from two sources—the surplus of receipts from tonnage dues to the close of the year 1790, and a loan, not to exceed \$2,000,000, which the President was authorized to make. These laws do not disclose the essential error of the sinking-fund policy, for they do not demand *inviolable payments*. It is true that authority was granted to borrow money with which to set the fund in operation, but this may, perhaps, be regarded as an extension of the refunding policy, rather than as part of the policy of debt-payment. Two loans sold in Holland were declared by Congress to meet the demands of the law, the proceeds of which were diverted to pay the first and second installments due the United States Bank; previous to 1795, the commissioners had received only \$434,901 from the sums thus borrowed. While, however, admitting that this clause does not prove Hamilton to have believed that money could be borrowed at simple and accumulated at compound interest, it is yet a good illustration of that confusion which he permitted occasionally to creep into public accounts—a confusion upon which some of his eulogists have placed too much reliance in supporting his claim to be ranked as a great financier.

Provisions for payment of the public debt made under the Federalist administration were completed by an act of March 3, 1795. According to this act, all moneys appropriated to the purchase of public stock were accumulated in

a fund to which, for the first time, was given the name of "The Sinking-Fund." The composition of this fund was as follows :

1. So much of the revenue of imposts and tonnage as, together with moneys already at the disposal of the commissioners, may be necessary to make an annual two-per-cent payment upon the principal of the six-per-cent stock for which the government was, in 1796, liable.
2. Dividends upon bank stock subscribed by the United States.
3. Sums from current revenue equal to the accruing interest upon public stock previously purchased or redeemed.
4. Net proceeds of the sale of public lands.
5. All moneys received by the United States on account of debts.
6. All surplus moneys remaining in the treasury at the close of any calendar year.

It is only necessary to consider the first and the third items making up this fund ; the others simply appropriate specific sources of revenue to a definite purpose. There can be no question but that Mr. Hamilton intended, by the first and the third clauses above given, to create an inviolable claim of varying amount upon current revenue. It will be remembered that the contract upon which the six-per-cent stock was issued prohibited payment at a rate more rapid than eight dollars in the hundred, for both principal and interest ; but by this law the payment of eight dollars was rendered obligatory, thus converting all this stock into a twenty-four-year annuity, over which the government no longer retained any discretion respecting payment. By the third clause the usual method of sinking-fund calculations was perpetuated, and this also in the mind of the Secretary constituted an inviolable payment. It was thought (to borrow a phrase from Dr. Price) that the indebtedness of the country would be kept in a constant state of extinction. Some writers seem to think that a financier must formally express his confidence in the efficiency of compound accumulations be-

fore naming him a supporter of the sinking-fund theory, but this declares the ignorance of the writers, and does not excuse the financier. The error of this theory of financing lies in the fact that it provides for automatic extinction of a debt. This leads to false security, and renders a country liable to the necessity of borrowing money at high rates while paying a debt that bears low rates. This evil was incorporated by Hamilton into American financing.

It is not necessary to rely upon inference for this conclusion. Hamilton's report of January 21, 1795, would have pleased the heart of Dr. Price. As the essay of the latter began with deprecating public incumbrances, so the report of the former begins with deprecating "that progressive accumulation of debt which must ultimately endanger all government." It was laid down as a "fundamental maxim that the creation of debt should always be accompanied with the means of extinguishment; this is the true secret for rendering public credit immortal." It is possible to interpret such an expression into a sound rule of finance. It is true that no debt of any magnitude should be created except accompanied by a law imposing taxes adequate for its final extinction. But in the present instance such an interpretation is not admissible, for in the same report we read, that sinking-fund appropriations "should be clothed with the character of private property," and that its application should be made "a part of the contract with the creditors." The principle enunciated by Hamilton is indeed a "fundamental maxim" of the theory of sinking-funds, but is not a fundamental maxim in sound national financing. It is an error to say that public credit is dependent upon maintaining inviolable payments; it depends rather on simplicity in public accounts, and upon energy on the part of the administration in the prosecution of whatever purpose it undertakes.

This is no place to trace in detail the operations of the Federalist sinking-fund. The last purchase of public stock was made in December, 1795, but the redemption of the an-

nuities and the payment of certain other debts continued, although it was found necessary to negotiate six separate loans previous to 1801, two of which were placed at 8 per cent. The result of financial operations during the twelve years of Federalist administration was to increase rather than decrease the Federal debt. Upon January 1, 1791, the amount of outstanding obligations was \$75,463,476; upon the corresponding date for 1795 the debt had risen to \$80,747,587. While Walcott was Secretary of the Treasury, the operations of the sinking-fund made no impression whatever upon the amount of indebtedness, and there was left by the Federalists as a legacy to the Jefferson administration a debt of \$80,700,000. Nothing is here said in criticism of the fact that the debt increased. That may have been a necessity under the circumstances. Nor do we undertake to decide whether this necessity was due to inefficiency on the part of the Federalist administration, or to the carping criticisms of the Republicans out of office; our only conclusion is, that it is unwise to play at paying a debt while the debt is in reality growing. This leads to false security, and becomes a most prolific source of new loans.

The financial ability of the Republican party was found in Albert Gallatin. When he took the portfolio of the Treasury Department, it was known that his views respecting the necessity of extinguishing the public debt were of the most pronounced character. These views he had expressed while a member of Congress, as he had before had occasion to put them into practice in Pennsylvania, his adopted State. The "payment of the debt was the great dogma of the democratic principle. 'The discharge of the debt is vital to the destinies of our government,' wrote Mr. Jefferson to Mr. Gallatin, in October, 1809, when the latter was desperately struggling to maintain his grasp upon the administration; 'we shall never see another President and Secretary of the Treasury making all other objects subordinate to this.'" ¹

¹ Adams's "Life of Gallatin," p. 270.

But did Gallatin believe in sinking-funds? That part of the law of 1795 which he declared to meet his approval is the part upon which we have relied to show that Hamilton was not entirely free from the influence of English methods of financing. In a letter of March 31, 1802, to the chairman of the Committee of Ways and Means, he says: "Nothing more seems necessary for those several objects [that is, for provision for the debts] than to make for the debts which are intended to be discharged as adequate a provision as is made by the act of March 3, 1795, for the payment of the eight-per-cent annuity of the six-per-cent and deferred stocks."¹ This seems to approve all that we have condemned, and if it means that permanent appropriations for debt-payments should be made part of a debt-contract, it certainly comes under the just censure of sound financing. But there are other expressions of Gallatin's which forbid that we accept this as his permanent opinion. He did not attempt to sweep away the sinking-fund legislation, because it was commonly regarded as a check upon the Secretary of the Treasury, and, to quote his own words, "owing to the prejudices of the times, the attempt would have been represented as impairing the plan already adopted for the payment of the debt."² He undertook, instead, to simplify it in its workings and render its accounts clear, although he characterized it as "the mystifying and useless machinery with which Mr. Hamilton had, in imitation of Mr. Pitt's sinking-fund, encumbered the very simple subject of paying the debt."³

The sinking-fund in the hands of the Republican Secretary was resolved into a permanent appropriation of \$7,300,-000 (afterward increased to \$8,000,000 on account of the Louisiana purchase), which was devoted to the support of the public debt.⁴ This sum, being largely in excess of the de-

¹ State Papers, "Finance," vol. i, p. 749.

² Quoted in Adams's "Life of Gallatin," p. 296.

³ Quoted from a letter to Gales and Seaton, February 5, 1835. "Writings of Gallatin," ii, p. 501.

⁴ Law of April 29, 1802.

mand for current interest, gave a certain surplus for the reduction of the principal. When the war of 1812 came on, the outstanding principal of the public debt had been reduced to \$45,120,304, consisting of \$16,723,208 of three-per-cent, which Gallatin would not pay; \$17,147,096 of six-per-cent that were under the condition of annuity payments; and \$11,250,000 of Louisiana stock, no part of which could be paid before 1818. During the continuance of the war there was no redemption of permanent indebtedness, except such as had been entailed by the law of 1795. The permanent appropriation to the service of the debt was continued, but it was assigned to the support of new loans. We find in the financial administration of this war, which in many respects is open to severe censure,¹ no application of the pernicious theory that every loan at its creation should be accompanied by the means of its own extinction.

There is disclosed in the administration of Mr. Gallatin the true policy of debt-payment. It consists in the establishment of a permanent appropriation for the service of the debt which shall be in excess of the demands of current interest. But such appropriation need not be "inviolable." It need form no part of a "private contract," nor be regarded as constituting "private property." A government should always be at liberty in time of emergency to divert money held for the payment of debt to the support of new loans. It may be said that such a policy is dangerous, and that without inviolable payments the country runs the risk of perpetual obligations; but experience shows it to be less dangerous than reliance upon automatic machinery for the extinction of obligations, as well as less expensive, if we consider the varying rates of interest in time of war and peace. The United States is indebted to Mr. Gallatin more than to any other man for the establishment of this policy. Under the guidance of his clear insight this country departed from the pernicious methods of English financing, and from his day

¹ Cf. *ante*, p. 112, sq.

to the present has the policy of debt-payment been, for the most part, clear, simple, and adequate.¹

At the close of the war of 1812 the Federal government found itself encumbered with a debt of about \$120,000,000. The permanent appropriation for the service of the debt was increased, and in 1834, without any material change in the financial policy so far as the debt was concerned, the United States had extinguished all its obligations. From that date until 1860 there is nothing of importance in the management of the public treasury to claim our present attention; but with the outbreak of the civil war American statesmen were again obliged to grapple with the intricacies of financial problems.

The financial policy of Secretary Chase has been already presented. His purpose was to carry through the war by means of loans, and, to secure a solid basis for such an extensive use of credit, he made the debt-charges a first lien upon all coin receipts.² These charges were of two sorts: first, the interest accruing upon bonds or notes; second, a sinking-fund payment equal to one per cent of the outstanding debt, increased by the accruing interest upon all debt thus redeemed.

We find here an application of the "fundamental maxim" that "the creation of a debt should always be accompanied with the means of its extinguishment." But such a law must surely lead to unnecessary embarrassment. Its requirement can not be followed under any conditions in which a resort to borrowing would be defensible, and it is folly to pass a law knowing it must be immediately broken. In the present instance the pressure upon the Treasury proved stronger than the theory of the Secretary. While the war continued, there

¹ It is interesting to notice what perfect harmony exists between Mr. Gallatin's administration and the principles of Robert Hamilton's "Essay on the English Debt," which is accredited with having overthrown the reasonings of Dr. Price. Compare, for example, the Report of 1811 with the propositions VII, VIII, and IX of the essay by Professor Hamilton.

² Sec. 5 of the law of February 25, 1862.

was no accumulation in the sinking-fund that by any pretense could be held as satisfying the demands of the law.

Nor can it be said that the establishment of a sinking-fund in 1862 exerted any influence upon the policy of debt-payment when the war was brought to a close. Secretary McCulloch, in his report of 1865, proceeded as though no such fund existed, and proposed that the policy of permanent appropriation should be adopted in making provision for the public debt. He estimated that the Federal debt would amount to \$3,000,000,000, demanding an annual payment in interest of \$150,000,000; and he proposed an annual appropriation of \$200,000,000 to the service of the debt, which, undisturbed by any refunding operations, would expunge the total debt in about twenty-eight years. But no law was ever passed which authorized such an appropriation. The method of procedure for a number of years was to apply such moneys as remained after the satisfaction of other demands to the reduction of the debt. For the year ending June 30, 1866, this surplus amounted to \$123,000,000, and during the fourteen months following August 31, 1865, the principal of the public debt was reduced \$206,000,000. This was a reduction of \$173,000,000 in excess of the demands of the law of 1862, and an advance of about \$125,000,000 over what would have been accomplished by the plan of appropriating \$200,000,000 to the service of the debt.

It was not until 1876 that we find the calculations of the amount due the sinking-fund assuming any importance. The question seems at this time to have been forced upon public attention by the law of 1875, providing for the resumption of specie payments. Nothing is plainer than that for the resumption of specie payments a government must have specie, and the Secretary of the Treasury was consequently authorized to sell bonds to replenish his stock of bullion. But why, it was asked, should the government redeem bonds bearing interest in gold while at the same time selling other bonds for gold with which to redeem greenbacks? Relying upon this view, it was proposed that the "claims of the sinking-

fund" should be suspended, and that the amounts due it accruing each year should be set aside as part of the coin destined to redeem the treasury notes. Something analogous to this was actually undertaken in applying the proceeds of the sinking-fund to the redemption of the debt bearing no interest. In the fiscal year ending June 30, 1876, \$7,000,000 of fractional currency were redeemed out of the fund, and the amount credited to the fund at 5 per cent interest.¹ Nearly \$6,000,000 of greenbacks, also, were redeemed out of the fund, the authority for the redemption being found in the Resumption Law of 1875.² Such an employment of the moneys due the sinking-fund did not pass unchallenged, nor did the suggestion that it be suspended meet with universal approval. But it was in this manner that the interpretation of the law of 1862 became a necessity.

The power to redeem bonds in excess of the demands of the sinking-fund had been freely exercised previous to 1870, but in that year it was thought wise to remove any possible doubt upon the subject. It was provided that the Secretary might redeem any five-twenty bonds "with any coin in the Treasury which he might lawfully apply to such purpose." We are told by Mr. Weston, whose current articles upon this and other subjects of national finances lead us to regard him as a faithful observer, that "certain parties endeavored to persuade Mr. Bristow, a succeeding Secretary, to treat these payments (in excess of the demands of the law of 1862) as superseding the sinking-fund for the future." This, however, he refused to do; and in this opinion other Secretaries have concurred. Mr. Morrill, who prepared the financial report for 1876, computed that the law of 1862, as modi-

¹ Law of April 17, 1876.

² The Resumption Act repealed the limitation which had been placed upon the ability of National Banking associations to issue notes, but at the same time obliged the Secretary of the Treasury to redeem greenbacks equal to 80 per cent of new notes issued. It was under this provision of the law, as I understand the matter, that authority was found for calling in greenbacks. Mr. Weston, writing in the "Bankers' Magazine," speaks of a "monthly redemption of greenbacks authorized by the law of 1875," but I find no such provision. Cf. vol. xxii, p. 625.

fied by the law of 1870, which made all redeemed bonds a part of the sinking-fund, would have been satisfied by the redemption of \$433,848,215.37; but the actual reduction previous to June 30, 1876, was declared to have been \$656,992,226.44.¹ It was not, however, on this ac-

¹ This computation may be of interest. "From the time when the first act named was to go into effect until August 31, 1865, the demands upon the Treasury incident to the war were greatly in excess of the revenues to the government, and therefore there was no surplus income which could be applied to the extinguishment of the debt or the creation of a sinking-fund, and consequently the law providing for the fund was during that period necessarily rendered inoperative.

"It will be noticed that the statute contemplated that a certain sum should be applied within each fiscal year to the account of the sinking-fund. If the resources of the Treasury during each fiscal year, commencing with July, 1862, had been sufficient to have made a literal compliance with the conditions of the law practicable, the account would, at the close of the last fiscal year, have appeared upon the books of the department as follows:

"Amount for fiscal year 1863.....	\$5,556,269 97
" " 1864.....	12,184,090 52
" " 1865.....	20,238,683 45
" " 1866.....	30,490,707 15
" " 1867.....	33,080,581 88
" " 1868.....	33,736,306 85
" " 1869.....	34,638,937 03
" " 1870.....	35,959,651 99
" " 1871.....	36,370,257 59
" " 1872.....	36,507,573 43
" " 1873.....	36,859,924 20
" " 1874.....	38,012,930 63
" " 1875.....	39,536,019 66
" " 1876.....	40,681,831 02
Grand total.....	\$433,848,215 37

"On the 31st of August, 1865, the public debt, as represented upon the books of the department, and shown by the public-debt statement, reached its highest point, viz. :

Debt, less bonds issued to the various Pacific Railroads, and less cash in the Treasury.....	\$2,756,431,571 43
On June 30, 1876, the debt, including accrued interest, less bonds issued to the Pacific Railroad companies, and less cash in the Treasury, was.....	2,099,439,844 99
Reduction of the debt.....	\$656,992,226 44

"The terms of the law of February 25, 1862, required by the operations of the sinking-fund account that the public debt should be reduced in the sum of

count admitted that the claims of the sinking-fund could be suspended.

It seems, then, taking all things into consideration, that there is no ground for believing the law of 1862 to have exerted much influence in securing the expungement of so much of our public debt as has been already paid. The sinking-fund established by Secretary Chase has not served in fact as "the sheet-anchor of public credit." There are, indeed, some expressions in public debate which regard the law as forming part of the contract between the government and its creditors, but this view does not appear to have met with any popular response.¹ How, then, it may be asked, is it possible to explain the ease with which taxes have been maintained for the redemption of public bonds? Does this show greater firmness or higher wisdom on the part of American statesmen than may be claimed by statesmen of other countries? We have already seen that the contentment with which the English bear the taxes for the maintenance of their great debt, rather than rid themselves of it by a strenuous effort for a few years, is due to erroneous views which they entertain respecting taxes. They firmly believe that money left in the pockets of the people will surely fructify, and for this reason they demand the remission of every tax not needed for current expenditures. The willingness of the American people to maintain high taxes for the

\$483,848,215.87 between July 1, 1862, and the close of the last fiscal year. A reduction has been effected during that period of \$656,992,226.44, or \$228,144,011.07 more than was absolutely required.

It can therefore be said, as a matter of fact, that all of the pledges and obligations of the government, to make provision for the sinking-fund and the cancellation of the public debt, have been fully met and carried out."

¹ Mr. Sherman was accustomed to insist on the sacredness of the contract when speaking in Congress, but as Secretary, in the secrecy of the room of the Senate Committee on Finance, he said of the sinking-fund: "This act can only be construed as an authority to purchase the debt in case of surplus revenue for the purpose. Whatever binding force it may have on Congress is not for me to say. There is no particular necessity for this law." (Interview of January 30, 1880. p. 45.)

payment of their debt is in like manner due to the prevalence of an economic error, though one of a wholly different sort. It is held in this country that customs duties are the occasion of private gain; why, then, should complaint be made of their maintenance for the payment of the debt? No financial problem has occasioned so much embarrassment in this country as the reduction of taxes, and it is because this problem has proven so difficult of solution that the debt has been managed with ease. It is the policy of protection that has paid our debts. This was true in the period from 1816 to 1836, and it is true at the present time. The wisdom of our statesmen consists in this, that they have not used unwisely the surplus revenue forced upon them by a radically pernicious system of taxation.

H It remains for us to consider the policy of debt-payment in its relation to the national banking system, a question, it will be remembered, brought to our notice in the previous chapter. There are many who believe the system of national banks in this country to be the best the world has ever seen, and who, on that account, are disinclined to favor any policy of debt-payment which unnecessarily endangers its maintenance. They do not advocate the continuance of the debt in order to continue the banks, but they do urge that, so long as the debt shall exist, it is wise to use it in such a manner as to be of indirect service to the public. At least, it is on the basis of such a premise that the following suggestions are made.

It is hardly necessary to speak at length of the nature of the embarrassment under which the banking system lies. The difficulty springs from the fact that the bonds upon which it is most profitable for the banks to do business are the only bonds which the government is at liberty to pay. As has been already stated, the public debt lies in three classes of bonds—the three-per-cents redeemable at the pleasure of the government; the four-and-a-half-per-cents redeemable in 1891; and the four-per-cents redeemable in 1907. The bonds of the second and third classes are worth from

12 to 20 per cent premium, and it is claimed that a higher profit may be made in private banking, on the basis of a given amount of disposable capital, than in the purchase of high-priced bonds as security for circulation of notes. This is due to the fact that the banking law permits the issue of circulating notes equal to 90 per cent only of the par value, not the market value, of the bonds deposited as security. But if the present policy of debt-payment continues, the banks must soon choose between the purchase of four-percents at 120 and the withdrawal of their notes from circulation.

The danger to the permanency of the banking system thus pointed out is not fanciful, as may be seen from the following table, which gives the amounts of various sorts of bonds held as security for circulation since 1883 :

BONDS.	1883.	1884.	1885.	1886.
Three-and-a-halves ..	\$632,000	.....	.....	.....
Threes	201,827,750	\$155,604,400	\$188,920,650	\$69,088,050
Four-and-a-halfs ..	41,819,700	49,587,480	49,547,250	57,436,850
Pacific sixes.....	8,463,000	8,469,000	8,505,000	8,586,000
Fours.....	106,164,850	116,705,450	116,391,650	115,388,150
Total.....	\$852,907,800	\$825,816,800	\$808,364,550	\$245,444,050

From this table it appears that the three-percents are fast being extinguished, and that there is no purchase of bonds of the other classes with which to keep up the circulation of bank-notes. The banks which now hold four-percents purchased them when their price was low, and their refusal to sell, notwithstanding the high profit which they might in this manner secure, is in part due to the continued pressure of dull times. Should business revive, so that free capital might easily find paying investments, there is reason to believe that the tendency disclosed by the above table would work with increased rapidity. The problem thus presented might be solved by amending the banking law, but we are only interested in proposals for its solution by some modification of the policy of debt-payment. One way in

which the difficulty might be overcome would be to expend the \$50,000,000 annually due the sinking-fund, and such surplus revenue as goes to debt-payment, in the purchase of high-priced stock at its market rates. This would leave three-per-cent stock to serve as the basis of banking circulation. It is true that there is not enough three-per-cent stock now left to make this proposal worth considering, were it not that it calls our attention to a new principle of debt-payment, and it is possible that some analogous plan will be presented in connection with the four-and-a-half-percents which fall under the control of the government in 1891.

The question thus brought to our notice is the question of paying a public debt by purchases at current rates on the market. It is, however, a question that may be easily understood. Payments by purchase at market rates may be advantageous to the government if stocks at discount are moving toward par. Under such conditions, not only is a large nominal debt expunged with a small payment, but a given annuity may be extinguished by a smaller payment than would be possible after the bonds had attained their par value. It is also true that, if bonds are above par, and the contract is so drawn that there is no tendency for them to fall as the years pass, it would be quite immaterial whether such bonds should be paid by purchase, or bonds standing at par, and giving the same return on capital invested, should be paid by calls.

But neither of these assumptions conforms to the condition of debt in the United States. The four-per-cent bonds are now worth 120, but by 1907 they must, of necessity, come down to par. The three-percents, now redeemable, are at par. The question involved in the proposal to purchase the high-priced bonds may be clearly stated if we ask what is the balance of advantage in the expenditure of \$100 in the two methods proposed. If this sum be expended in the redemption of four-percents at premium, rather than in the purchase of three-percents at par, the government makes an immediate gain of 33½ cents. That is to say, in the first

case, the expenditure of \$100 has extinguished an annuity of \$3.33 $\frac{1}{3}$; in the second case, it has extinguished an annuity of \$3. This difference may, of course, be put immediately to profitable use in increasing the fund with which future purchases are made. But, on the other hand, there is a loss attending this gain. At the expiration of twenty years the four-per-cents will be redeemable at par, so that the purchase of these bonds at their present price would entail a loss equal to the premium paid. For the expenditure of \$100, this loss would amount to \$12.66 $\frac{2}{3}$. The question, therefore, reduced itself to this: Will an immediate saving of 33 $\frac{1}{3}$ cents improved at 4 per cent compound interest, strengthened each year by a corresponding saving, though less in amount as the years pass, attain, in twenty years, to the sum of \$12.66 $\frac{2}{3}$. We can not tell exactly what such an improvement would amount to, for the saving added each year, chargeable to the liberation of interest payments, is not a constant factor; but the most advantageous calculation would not bring the amount to exceed \$10. From such a statement of the case, it is clear that the payment of premium stock at market rates, when the stock is constantly falling toward par, is an expensive operation. It does not conform to sound rules of finance, provided there is any other stock upon which the surplus revenue may be expended.

Another proposal for adjusting the policy of debt-payment to the requirements of the banking system finds expression in a bill recently introduced into the Senate by Mr. Aldrich. It is proposed to expend the revenue available for debt extinction in paying part of the interest upon the high-priced bonds before that interest becomes due. This is in reality a scheme for converting part of the debt into such form that it may profitably be used by the banks as basis for circulation. The details of the plan are as follows: The holder of a bond bearing 4 per cent or 4 $\frac{1}{2}$ per cent interest is granted the liberty of exchanging it for a bond bearing 2 $\frac{1}{2}$ per cent interest, the exchange to take place on the basis of the par value of the bonds. But, in consid-

eration of the reduced interest, the holder is to receive in lump a sum of money equal to the aggregate present worth of the various interest payments he would have received on the original bonds, above the $2\frac{1}{2}$ per cent interest he continues to receive on the new bond. The present worth of these payments is to be calculated on the basis of not less than 3 per cent interest, re-invested quarter-yearly. It is also provided that these bonds bearing a reduced rate of interest shall not be paid until all bonds bearing a higher rate of interest shall have been extinguished, and that of these converted bonds those first issued shall be the last paid.

It is doubtful if this scheme of conversion would meet the hearty approval of large numbers of bond-holders; but it would certainly commend itself to those bankers who desire to continue the circulation of bank notes; for it would give back to the banks, in the form of anticipated payments of accruing interest, the capital now uselessly tied up in the high-priced bonds deposited as security for notes. The only question, then, seems to be: Does the plan proposed run counter to any public interest? It will be noticed that there is one essential difference between the anticipation of interest-payments, and the anticipation of the payment of the principal of a debt by purchases on the market. This latter procedure, as has been shown, is expensive, because it requires a larger sum of money to extinguish a given debt than will be required after the debt comes to be redeemable; but no such result follows the anticipation of interest-payments. These are determined by the terms of the contract, and may be calculated with accuracy. The interest does not, like the market value of a debt, fall as the bonds approach the period of their redemption, and it is but the application of sound business rules to use any surplus moneys on hand in making advanced payments of interest. This plan, then, introduced by Senator Aldrich, seems to be adequate to the purpose for which it was drawn.

But should Congress succeed in adjusting the debt to the requirements of the banking system, its management in the

future presents yet other difficulties. The three-per-cent will probably be paid during the course of the coming year, but the four-and-a-half-per-cent will not come under the control of the government till 1891. What is to be done with the permanent appropriation to the sinking-fund, until it can be economically used in discharging the four-and-a-half-percent bonds? Or, supposing this difficulty to have been successfully overcome, the amount of debt redeemable in 1891 is but \$250,000,000; and, with a sinking-fund appropriation of \$50,000,000 a year, we shall find ourselves in 1896 again without any debt upon which the appropriation may be expended. In what manner shall the machinery of debt-payment be managed from 1896 to 1907?

In this latter case, it will probably be wise for the sinking-fund law to be repealed, or, at least, for its operations to be suspended. The time is sufficiently extended to warrant changes in the rates of taxation. Such a proposal does not, however, fit the requirements of the first case. Three years only intervene between the extinction of the three-per-cent and the time when the four-and-a-half-per-cent bonds are redeemable, and for so short a time the suspension of the ordinary payments would be the source of great inconvenience. It will be observed that I am arguing as though all unnecessary taxes had been repealed, for it is impossible to proceed rationally in considering the finances of the Federal government except we assume the criminally absurd policy of surplus financing to have been abandoned. Were it, however, true that income were reduced to the level of expenditure, a suspension of the operation of the sinking-fund would require a yet further reduction of taxes; but since the taxes thus remitted must be re-imposed in 1891, the evils accompanying the change might be more serious than the expenditure of the appropriation in purchase of high-priced bonds. Indeed, I am inclined to the opinion that the direct purchase of \$150,000,000 of second-class bonds would be preferable to the suspension of the sinking-fund for three years, were these the only alternatives presented to Congress.

But there is another manner in which this difficulty may be overcome. It is not uncommon for financiers to apply the moneys due a sinking-fund to the purchase of other property than the debt which the fund is supposed to extinguish. The property thus purchased is held as an offset to the stock that should have been redeemed, but which is permitted to remain in the hands of public creditors. If the property purchased be the source of annual revenue equal to the interest paid upon the stock maintained, the public is freed from all taxes for support of the debt, and reaps the practical results of debt-extinction. Or, if the new property bear a higher rate of profit than the rate of interest upon the stock outstanding, the government gains by the operation. By such a transaction the government takes advantage of its own high credit to effect a saving for the people. The practical benefits of the transaction are those which follow the conversion of public stock into bonds bearing a lower rate of interest.

There is nothing new in the proposal thus suggested. The debt of France, for example, is not regarded as the source of possible embarrassment in the future, for the entire railroad property is conceived by French financiers to be charged with its extinction. Much more to our purpose, however, is a proposal of Mr. R. Dudley Baxter. This gentleman suggests that the duties imposed upon English railways, amounting to nearly £500,000, shall be appropriated to establish a sinking-fund for the expungement of the English debt. But this appropriation and the accumulations, "instead of being invested in the debt itself, like sinking-funds which have failed, he proposes to invest in ordinary or preference stock of railways, yielding at least a dividend of 4 per cent. By so doing, he calculates that at the end of seventy-two years the nation will be possessed of about £200,000,000 of railway stock, the annual revenue of which at no more than 4 per cent will be equal to the interest on £250,000,000 of consols."¹ Such an operation would result, assuming the calcu-

¹ Robert Giffen, "Essays in Finance." First series, p. 262.

lation to be correct, in the practical extinction of £250,000,000 of public debt by an investment of £200,000,000 of money, a gain which arises from the superior credit of the state as compared with that of railway corporations.

Is it possible for the United States to adopt at the present time a plan for the management of its sinking-fund similar in principle to the one suggested by Mr. Baxter? Could this be done without detriment to public credit, and without loss to the treasury, the immediate difficulty which springs from the redemption of the three-per-cent bonds would disappear, while at the same time the claims of the sinking-fund would be satisfied. But the practical question is: How may this appropriation of \$50,000,000 a year be advantageously employed? In reply to this question, our minds turn most naturally to the suggestion that Congress authorize the Secretary of the Treasury to purchase local and State bonds, in place of redeeming the bonds of the Federal government. These, for the most part, bear a higher rate of interest than the bonds which would otherwise be redeemed, and there is no reason why the purchases might not be perfectly safe if not pushed too far. Nor can it be said that such purchase would raise the price of local bonds; for, in all probability, the money spent by the government in this manner would be just the money that would be spent by private individuals had the government chosen to redeem its own bonds. The only real objection to this proposal arises from the political relations that exist between the Federal government on the one hand, and the States and minor civil divisions on the other. As we have seen, the States are sovereign in all matters of contract, and the difficulty of enforcing the bonds of cities and counties would be increased were the Federal government to become the creditor.

We are not, however, restricted to a purchase of local debt, in the application of the moneys due the sinking-fund. It seems to be a foregone conclusion that, sooner or later, the telegraph property of this country will come under the administration of the Federal government, and there is no

time so advantageous as the present for setting this scheme on foot. Without going into the intricate question of the true value of this property, the price which the government would find it wise to pay is sufficiently near the sinking-fund appropriation for three years to make the proposal worth the consideration of Congress. But we must leave this as a mere suggestion, for its discussion passes beyond the proper boundary of our present study.

The conclusions of the present chapter are as follows :

The policy of debt-payment is defensible, and for two reasons : A people can not afford to wait until the burden of their debt is reduced by a fall in the value of money ; nor does the payment of the principal of a debt retard industrial development, but, on the other hand, the maintenance of the principal, and the continuous payment of interest, does obstruct industrial growth.

The policy of debt-payment, however, should not be pushed so rapidly as to force the rate of business profit below the rate necessary to sustain industrial hopefulness. The charge that this has been done in the United States is not well founded.

With regard to the methods of payment, it was found that the old sinking-fund theory was pernicious, because it made "inviolable appropriations," and that payment by means of terminable or life annuities was but a modification of the sinking-fund theory, and must for the most part be condemned. The best method of payment is the one introduced by Mr. Gallatin, of making permanent appropriations to the service of the debt and leaving the administration large discretion in their application.

Payment by purchase upon the market at market prices is defensible when bonds are below par, but not when above par and so conditioned as to be payable, within a reasonable time, at their nominal value. Under such circumstances it may be wise to divert the sinking-fund appropriation either to the payment of interest before it is due, or to the purchase of some other form of property than bonds.

PART III.

LOCAL DEFICIT FINANCIERING.

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CHAPTER I.

COMPARISON OF LOCAL WITH NATIONAL DEBTS.

WHATEVER principles for the management of a public debt have been discovered in the foregoing study, are of a quite general character. They are, for the most part, applicable to all peoples and to all forms of government; for they are such as arise from the necessary relations existing between the management of a public treasury and the social, industrial, and political habits of peoples. The study that follows is directed by a different purpose. Its most apparent design is to learn how far the general rules of finance may be applied by local officials in the performance of local duties; but the deeper intent for which it is undertaken springs from a desire to understand the course of financiering in our States and municipalities. It is well known that the Federal government on the one hand, and the municipalities and private corporations on the other, have encroached upon the original administrative functions of the States, so that at present they have little occasion to borrow money. We wish to inquire what causes are responsible for so significant a result. In contrast with this the cities are observed to have appealed to public credit regardless of consequences. The financial evils of municipal administration are so familiar that they cease to be the occasion of surprise, and it is important to learn whether such evils are traceable

to a disregard of financial principles, to some radical defect in the organization of city government, or to the imperfect development of society itself. No words are required to show the pertinency of such a study.

The remainder of this essay will be shaped by the purpose here set forth; but before entering upon the historical treatment of the subject, it will be well to bring the technical part of our task to a close. Is it possible for local officials, in administration of local affairs, to adopt those rules for the management of a treasury applicable to the guidance of national finances? An appropriate answer to this question calls for two quite distinct lines of analysis. The first of these leads us to notice the legal status of those civil divisions granted the power to create debt; by the second, we are brought to consider the distribution of functions between the various grades of government, and the nature of the duties thus imposed upon each.

Comparison of Local and National Debts on the Basis of their Legal Character.

American constitutional law recognizes three distinct grades of government. The first of these is the National government, composed of the Federal Executive, the National Congress, and the Federal Judiciary. In the second grade are found the governments of the various States, imposed with administrative duties complementary to those of the Federal government. These are separate and independent centers of power, thirty-eight in number, each of which exercises a carefully-defined jurisdiction over a limited territorial domain. The third grade of government is composed of the various minor civil divisions. According to the census of 1880, there were then in round numbers 2,400 counties; 311 cities and towns, with a population of 7,500 and upward; about 8,000 incorporated cities, villages, and other small places with a population below 7,500; about 12,000 townships having a financial existence; and 105,000 school-districts possessing power to contract a debt and levy a tax.

It may appear at first blush that the principles underlying public law must be very difficult to trace, because of the numerous centers of power they are called upon to recognize; and this apparent complexity is increased when it is learned that no one of these several grades of government is regarded as the exclusive representative of sovereignty. The matter, however, is not so difficult as it seems, and may be easily understood when one learns whence sovereignty comes, and what marks the limit of its exercise by any of the grades of government.

The theory of our political system [says an eminent jurist] is that the ultimate sovereignty is in the people, from whom springs all legitimate authority. . . . The people of the Union created a national constitution, and conferred upon it powers of sovereignty over certain subjects, and the people of each State created a State government, to exercise the remaining powers of sovereignty, so far as they were disposed to allow them to be exercised at all.¹

From this it appears that the sovereignty which American constitutional law recognizes is popular sovereignty, legally expressed; and he who would understand how the various grades of government are related to each other, must notice, not alone the limit of their territorial jurisdiction, but the specific duties that are assigned to each. The sum of all these duties, exercised by the various centers of power, makes up the totality of functions that may be legally entered upon by governmental agency. This is the characteristic feature of American institutions. The limit of legal right to exercise sovereign powers is found in the special functions assigned to each grade of government. Should any of these various governments undertake duties outside those assigned them, they are acting illegally; for, in so doing, they encroach either upon the jurisdiction of one of the other grades of government, or upon a domain of activity which the people, by failure to enumerate in any of their grants of power, have thereby declared shall not be en-

¹ Cooley's "Constitutional Limitations," p. 36.

tered upon by public authority. The harmony of American institutions is, in consequence, found in the public law, which assigns duties to those bodies which it creates, while at the same time it limits their activity to the performance of the duties assigned.

It is a significant fact that the balance in local indebtedness conforms quite closely to the lines drawn by American constitutional law. This is partially explained when we notice that the development of public law is something of a record of those manifold changes which make up social development, and of which the employment of local credit is an expression. But it is more directly due to the interpretation placed by the courts upon the contracts entered into when a city or a State borrows money. The balance of indebtedness within the last thirty years has shifted from the States to the minor civil divisions, and this can only be understood after learning the legal character of debt-paper and the inducements which led to a resort to credit.

The legal character of a Federal bond has been already described. It is a simple contract between a subject on the one hand and a sovereign on the other. If a subject lend money to his own government, he holds no remedy at law should payment be refused ; or, if the creditor of a defaulting State be the subject of a foreign power, he exhausts his full legal right in petitioning his own government to make his grievance the occasion of diplomatic correspondence. No government that enjoys the privileges of sovereignty can be forced against its will to appear in court as a defendant. How does this matter stand with regard to the promises of the commonwealths that make up the Federal Union ? Are such contracts of a sovereign character ? If we compare the duties assigned to the three grades of governments mentioned above, it will be found that the activity of the States holds in view the same general purposes as that of the minor civil divisions. Indeed, public law assumes that counties and cities perform gratuitously what otherwise must have been done at State expense. The duties of the Federal government, on the other

hand, call into frequent exercise the power of national sovereignty. On this account it might be reasonably expected that a State contract would be similar to that of a city or a county, rather than conform in legal character to that of a Federal bond. This is not, however, the case. Another theory of constitutional interpretation has given a distinctively sovereign character to the obligations of States.

It will be remembered that the powers of the commonwealths, as well as those of the Federal government, came directly from the people, while those of the municipalities were derived indirectly through the local legislatures; for this reason it has come about that a State bond and a Federal bond stand before the law as a contract of the same grade, while the bond of a city or of a county possesses altogether a different character. A State contract lies beyond the reach of the courts, and no power of mandamus can enforce the levy of a tax to insure its payment.

It certainly seems a little anomalous that a grade of government limited to the exercise of local functions, and never called upon to borrow money except for industrial purposes or for the purpose of local defense,¹ should be granted the protecting robe of complete sovereignty the moment it assumes the rôle of a debtor. Among the least of the criticisms suggested by this state of affairs is the fact that it shows inconsistency in our public law. Here is an established government, with no jurisdiction over questions of war and peace, yet permitted to take steps that, according to universally accepted rules of international law, may lead directly to foreign complications. The duty of protecting all citizens of the United States from foreign interference is assigned to the Federal government, but with this duty there is conferred no power of restraining the States from entering into financial engagements with foreign peoples that may give

¹ Even in the case of local defense or a local insurrection, the governor of a State may call upon the President of the United States for assistance. There is no occasion for local war-debts.

rise to controversy, or of taking steps by which disputes may be settled.

But this peculiarity of public law may be presented in a more serious light. The sovereignty which States take upon themselves when they become debtors is believed to be the source of administrative weakness ; and, if the history of the entire subject as it unfolds before us shows this to be true, whoever regards it as desirable that the integrity of the commonwealths should be maintained must be willing to give up the shadow of sovereignty for the substance of power. This question of the legal character of debt-paper, appropriate to the use of governments of the intermediate grade, is one that may well be held in mind throughout the remainder of this study ; for it is closely allied to the question placing restrictions upon the inferior governments in the use of their credit.¹

Let us then inquire what thought has been bestowed by publicists and jurists upon the legal character of State bonds. So far as this appears in the records of judicial controversy, the question involved has been altogether one of legal procedure. The only question thus far presented to the court is the following : Can a State be made to appear as defendant in a suit brought by a private citizen ? There are three possible conditions in connection with which this question might arise. Thus, the plaintiff might be a citizen of the State refusing to meet the conditions of its obligations, he might be a citizen of another State, or he might be the subject of a foreign power. It is not, however, necessary to distinguish between these three classes of possible cases, for if relief were granted to one set of creditors it would probably be granted to all.

It is further worthy of notice that this immunity against suit now enjoyed by the States was not granted them by the Constitution as originally adopted. The language of that instrument, in defining the jurisdiction of the Federal court,

¹This question will be considered at length in the last chapter of this treatise.

is, that the power of the court should extend "to all controversies between two or more States [or] between a State and citizens of another State." There can be no doubt as to the literal interpretation of this language. It most certainly grants a citizen the right to summon a State as defendant before the bar of the Federal court. There are, however, the strongest reason for believing that the Constitution would never have been adopted had it been recognized, at the time the discussions respecting it were going on, that this interpretation would be accepted by the courts.¹

It was not long, however, before the Federal court was called upon to interpret this clause of the Constitution. In 1792 a citizen of South Carolina brought suit against the State of Georgia for the recovery of a debt.² The nature of this obligation is of no importance; the question forced into prominence by the Attorney-General, Mr. Randolph, and decided by the court was as follows: "Can the State of Georgia, being one of the United States of America, be made a party defendant in any case, in the Supreme Court of the United States, at the suit of a private citizen? To this the court, with one dissenting voice, answered in the affirmative. The simple reading of the document, independently of any intention on the part of the people, was accepted as final with the court." Immediately upon this decision, other suits were instituted of the same character. These aroused the attention of the States, and they made quick demand for some change in the organic law of the country, which should secure them against being called to appear as defendant at the suit of a private person, except in such cases as were provided for by their own laws. For example, judgment was rendered in a suit brought against

¹ We can not enter upon a discussion of this point, but the reasons for the opinion expressed may be suggested by the following references:

Elliot's "Debates," vol. iii, pp. 582, 543, 555; from which one may learn the view taken in the Virginia convention. Compare also Hamilton's views as expressed in the "Federalist," No. lxxxi.

² *Chisholm v. Georgia*, 2 Dallas, 419.

Massachusetts, and a process served on John Hancock, her governor. Resolutions were immediately passed by the general court of that commonwealth, which instructed her senators and representatives—

To adopt the most speedy and effectual measures in their power to obtain such amendments in the Constitution of the United States as will remove any clause or articles of the said Constitution which can be construed to imply or justify a decision that a State is compelled to answer in any suit by an individual or individuals in any courts of the United States.¹

Other States took active measures looking toward the same end.

As a result of this agitation, the eleventh amendment² was adopted, which has secured the States in their sovereign character as public debtors. This amendment declares that:

The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another State, or by citizens or subjects of any foreign state.

The principle involved in this amendment, which it must be confessed has destroyed the harmony and completeness that at first existed in American public law, has controlled all subsequent decisions. There has, so far as I am aware, been but one attempt to break its force. A few years ago certain acts were passed by the legislatures of the States of New Hampshire and New York for the purpose of protecting their citizens who might be holders of repudiated bonds of other States. The form of procedure instituted by these laws was altogether simple. It will be noticed that the amend-

¹ "United States Reports," vol. civii, p. 88.

² It has been stated that this amendment was not passed in defense of the sovereignty of the States, but merely as a business procedure. Thus, there were many claims, unjust in themselves, but which according to law might be successfully pleaded, and it was thought best to permit these claims to be urged before a body that could judge of their equity as well as their validity. This is the view of the matter taken by the court itself, as may be seen from a later decision. Cf. *Cohens v. Virginia*, 6 Wheaton, 406.

ment did not take from the Federal court the right of original jurisdiction over cases that might arise between States. These laws, therefore, permitted individuals, citizens of either State, to assign an unsatisfied obligation to their respective States, in which case the State was to bring suit for recovery in its own name.¹

It requires no very exhaustive study of constitutional law to discern the puerile character of this attempt to evade the plain intention of the eleventh amendment. When these

¹ The following is the text of the New York law:

AN ACT to protect the rights of citizens of this State owning and holding claims against other States, passed May 15, 1880.

The People of the State of New York, represented in Senate and Assembly, do enact as follows :

Section 1. Any citizen of this State, being the owner and holder of any valid claim against any of the United States of America, arising upon a written obligation to pay money, made, executed, and delivered by such State, which obligation shall be past due and unpaid, may assign the same to the State of New York, and deliver the assignment thereof to the Attorney-General of the State. Such assignment shall be in writing, and shall be duly acknowledged before an officer authorized to take the acknowledgment of deeds, and the certificate of such acknowledgment shall be duly indorsed upon such assignment before the delivery thereof. Every such assignment shall contain a guarantee on the part of the assignor, to be approved by the Attorney-General, of the expenses of the collection of such claim, and it shall be the duty of the Attorney-General, on receiving such assignment, to require, on behalf of such assignor, such security for said guarantee as he shall deem adequate.

Sec. 2. Upon the execution and delivery of such assignment in the manner provided for in Section 1 of this act, and furnishing the security as in said section provided, and the delivery of such claim to him, the Attorney-General shall bring and prosecute such action or proceeding, in the name of the State of New York, as shall be necessary for the recovery of the money due on such claim, and the said Attorney-General shall prosecute such action or proceeding to final judgment, and shall take such proceedings after judgment as may be necessary to effectuate the same.

Sec. 3. The Attorney-General shall forthwith deliver to the Treasurer of the State, for the use of said assignor, all moneys collected upon such claim, first deducting therefrom all expenses incurred by him in the collection thereof, and said assignor or his legal representatives shall be paid said money by said treasurer upon producing the check or draft therefor of the Attorney-General to his or their order and proof of his or their identity.

Sec. 4. This act shall take effect immediately.

enactments came before the Supreme Court, they were, without much ceremony, set aside as unconstitutional.¹ The case of the plaintiff rested upon two arguments: the one, already recited, that the suit was in reality a suit between States, permitted and consequently provided for by the Constitution; the other, that a State was the sovereign trustee for its people, and on this account was clothed with the right and faculty of making imperative demands upon independent States for the payment of debts due its citizens.

In answer to the first claim, the court decided that the States, as parties prosecuting to the suits, were "nothing less than collecting agents of the owners of the bonds and coupons," and in consequence refused to admit the suits. In answer to the second claim, the court pointed out the essential difference between the sovereignty of a State vested with the power to declare war and determine peace, and that of a State from which that power has been taken. The claims were therefore not allowed.

This decision seems to set aside all hope for legal remedy so long as the general principle of the eleventh amendment controls the judgments of the court. And, indeed, should the difficulty imposed by this part of the organic law be removed, it might yet remain a question how judgments favorable to a plaintiff could be enforced against the wish of a State legislature. The only method of procedure known to the court is by a writ of mandamus, but this sovereign writ extends no further than to the enforcement of ministerial functions established by some definite law. It is not too much to say that, without a complete modification of the relation existing between the States and the Federal government, the holder of a State bond relies wholly upon the faith of the local legislature for security in his property.

It is interesting to inquire if other than legal methods have ever been suggested for the enforcement of debts of

¹ Cf. case, *New Hampshire v. Louisiana*, and *New York v. Louisiana*. "United States Reports," vol. civii.

this sort. There have been some suggestions looking in this direction, but it is difficult to say if they were presented in good faith. Thus, the proposal has appeared in print that States refusing to satisfy just demands should be deprived of their representation in Congress. It is charitable to regard this as a sarcasm upon the present condition of public law, for certainly if the individual States are denied the right of secession, the Federal government can not properly exercise the right of ejection. A more interesting proposal of the same sort is traceable to the pen of John Quincy Adams. Being a member of the committee of the House of Representatives, in 1843, to which was referred a plan for the resumption of the existing State debts, he moved, upon March 2d of that year, the following extraordinary resolutions, as substitutes for those presented by the committee:

1. *Resolved*, That the repudiation by any State of this Union of any debt to foreigners, contracted by authority of the Legislature of said State, is a violation of the Constitution of the United States, in the first paragraph of the tenth section of the first article, which provides that no State shall pass any law impairing the obligation of contracts.

2. *Resolved*, That if any State of this Union, by or in consequence of such repudiation, involve herself in war with any foreign power, the Congress of the United States has no power to involve them, or any other of the States of this Union, or the people thereof, in such war.

3. *Resolved*, That, in the event of such a war, the State involving herself therein will cease thereby to be a State of this Union, and will have no right or claim to aid in her defense from the United States, or any one of them.¹

It is probable that Mr. Adams intended no more by these resolutions than to bring squarely before Congress the anomalous condition of American law. He knew they would not be acted upon, for they were moved as a minority substitute for the report of a committee that, had it been unanimous in its recommendations, could have secured no following in the House. Nothing but a willing surrender by the States

¹ Johnson's Report upon the "Relief of the States," p. 559. Being Report No. 296, 27th Congress, 3d session, House of Representatives.

of their sovereign character as borrowers of money can give their creditors a legal guarantee for capital loaned. Whether or not it would be wise to urge such a measure upon the people is a pertinent question in the present state of affairs, but a question for which an intimate knowledge of the history of local debts can alone furnish an answer. We may then pass, for the time, further consideration of the States as centers of indebtedness, to inquire how municipal corporations stand before the law when creating pecuniary obligations against themselves.

The various governments of the third grade, known under the generic name of municipal corporations, are the creatures of the States, and wholly under their control. They are created by general law or by special charter, and find in such law or charter the limit of both their duties and their privileges. According to the accepted theory of law, a municipality performs nothing for itself, but in caring for local affairs it performs a gratuitous service for the State. This theory gives color to all the contracts of inferior governments. If a municipal corporation be the creature of the State legislature and act as the agent of the State, the character of sovereignty can not attach to its promises. It is universally provided that minor civil divisions may be forced to appear as parties-defendant in civil suits; and from this it follows that if a county or city bond be declared a valid obligation, its holder possesses a clear remedy in case payment upon it is refused. This fact, that the bonds of civil corporations may be made the basis of legal procedure, goes far in explaining the ease with which cities can procure money on credit. It is only necessary to know that the corporation acts within its legal authority in issuing obligations, and its bonds may be regarded as a safe investment.

It is not intended to leave the impression that public law relative to municipal bonds is altogether clear and simple; the learned treatises upon this subject, and the multitude of cases that have come before the courts, declare how erroneous would be such an impression. Indeed, it is not possible to

proceed much further than the general statements presented above, unless one is willing to confine his attention to some particular locality. The courts of Massachusetts, for example, as also those of the New England States in general, follow a rule for collecting a judgment against a municipal corporation quite peculiar to themselves. It is the general practice in these States that "judgments against a *quasi* corporation may be satisfied out of the property of any individual inhabitant." That is to say, the legal rule of partnership seems to be applied to the citizens of a municipality. The individual whose private property is attached to satisfy a public claim would, of course, have just action against other citizens if the corporation refused to reimburse him for the payment; and the consequence is that the corporate authorities will certainly provide for meeting such claims as can be sustained in the courts. Outside of New England it is not permitted to issue writs against the inhabitants of towns as parties to a city contract, nor would it be feasible to introduce this method of procedure in other States. "This practice," says Judge J. G. Brainard, "with regard to towns, has prevailed in New England from an early period—from its first settlement—a practice brought by our forefathers from England, which had there obtained in corporations similar to the towns incorporate in New England."¹

It is quite possible, also, that this proprietary view of the relation existing between the inhabitants of a town was strengthened by the character of the old colonial governments and political practices. The perfect equality among all members of the civil corporations, the democratic organization of the churches, and, above all, the practices of the town meetings, must have led naturally to this sense of personal responsibility for all public acts. But in the Southern States, whose history and habits of thought have been quite different; or in the Western States, where governments were provided for even before settlers made their appearance,

¹ 6 Conn. 228, cited by Cooley in "Constitutional Limitations," p. 301.

it would be impossible to recognize the responsibility of individuals for obligations incurred by the civil authorities.

It is sometimes urged, in favor of an extension of this New England method of procedure, that a municipal corporation has no common fund apart from the property of its citizen-members. This might be tenable if other means of enforcing public obligations were not provided. This is the view taken by Judge T. M. Cooley. He says:

So far as this rule rests upon the reason that these organizations have no common fund, and that no other mode exists by which demands against them can be enforced, it can not be considered applicable to those States where express provision is made by law for compulsory taxation to satisfy any judgment recovered against the corporate body—the duty of levying the tax being imposed upon some officer who may be compelled by *mandamus* to perform it. Nor has any usage, so far as we are aware, grown up in any of the newer States, like that which had so early an origin in New England. More just, convenient, and inexpensive modes of enforcing their demand have been established by statute, and the rules concerning them are conformed more closely to those which are established for other corporations.¹

An examination of the provisions for recovering judgments against civil corporations established by other than the New England States, shows that payment can not be avoided except through the acquiescence of the State legislature, or by its direct assistance. The principle according to which compulsory taxation is defended is altogether tenable, resting as it does upon the ground "that when a political corporation has contracted a debt, or incurred an obligation, it has already taken the initiatory step in taxation, and has, in effect, given its consent that the subsequent steps, so far as they may be essential to the discharge of such debt or obligation, may be taken." But the spirit of strict fidelity to obligations incurred is seldom stronger in the legislatures than in the localities themselves, and it sometimes happens that municipal authorities find their delinquencies encouraged rather than their duties enforced. Still the matter does not rest wholly with the legislatures. If the courts remain untainted by the spirit

¹ "Constitutional Limitations," p. 302.

of repudiation, they can usually discover some legal method of enforcing valid obligations ; or, if this be impossible, the penalty which they are able to exact for repudiation is so severe that most corporations prefer the payment of the necessary taxes.¹ It seems, then, that the general truth respecting the bonds of minor civil divisions is that, if issued conformably to legal requirements, they may be made to serve as the basis of successful suit at law ; and in this respect they differ from the bonds of the Federal government or from those of the several States. As already suggested, this fact must be held in view in endeavoring to explain the balance of local indebtedness.

Comparison of Local and National Debts on the Basis of Functions Assigned.

The rule according to which public functions are allotted to the various centers of power in the United States is quite

¹ There are three methods by which political corporations have endeavored to elude the payment of valid claims.

1. They have secured the enactment of State laws limiting the rate of taxation ; providing them for current expenditure so as to exhaust the proceeds of taxes permitted by law, they have urged their inability to meet outstanding claims. The courts, however, have quite generally held that such restrictions could not be construed as applying to bonds issued before the enactment of the law ; while for bonds issued subsequent to its enactment, one condition of their legality is that they shall not cause such an addition to the tax levy for current and necessary expenditure as to bring the total levy above the legal limit. This method, therefore, of evading valid claims, seems to be inadequate to the demands made upon it.

2. Cities have sometimes secured from the legislature a revocation of their charter. The Memphis case is the important case bearing upon this point. In this instance judgment was secured against the representatives of the defunct corporation ; but as nothing in the nature of assets existed, it was impossible for the receiver to satisfy the judgment. Thus it appears that by abolishing self-government the citizens of a municipality may avoid their financial responsibilities.

3. The third method of evading payment consists in the repeated resignation of public officers. But although this may be kept up for a number of years, it has never, so far as I am aware, succeeded in extinguishing a valid claim against a municipality. It is possible for towns to become bankrupt, so that creditors find it for their interest to reduce their claims ; but it would be an extraordinary procedure for a court to order such a reduction.

simple for one who understands the political philosophy of democratic governments. The safety of democratic institutions lies in the realization of local self-government, and the principle that controls in matters of organization is that the administration of all powers should lie as closely as possible to those interested in their exercise. This theory of allotment would grant to the Federal government all duties touching purely national and sovereign questions; it would press upon the local centers of administration such functions as are of peculiar local interest; while the States, standing between the two, would gather up into themselves all the remaining powers that the people have chosen to place out of their own immediate control.

From this it seems natural to expect that local financing should differ from that of the Federal government chiefly in the variety of purposes for which money is borrowed, and a glance at the history of local administration shows this expectation to have been met. The commonwealths have frequently borrowed money for purposes regarded as lying outside the appropriate duties of Congress, and, when we come to consider the course of municipal financing since 1860, it will be seen that the activity of the minor civil divisions has also greatly extended.

The first occasion upon which the States employed their credit as a source of revenue brings to view the financial operations of the Revolutionary War. There was, at this time, much confusion, both of thought and of action, and the line of distinction between the local duties of the States and the comprehensive duties of the central government had not yet been drawn. The States had not yet surrendered any part of their sovereignty, and in consequence the administration of their treasury departments was largely shaped by national ideas. It is for this reason that the first period of local indebtedness records nothing of interest to the present comparison. The States did not again come forward as borrowers of money until about 1830. The development of the railroad system, which has since revolutionized all industrial

methods, had at this time just begun, and it was not then believed that private enterprise was adequate to the extensive demands of the public for highways of inland commerce. The wildest expectations were entertained respecting the efficacy of public improvements, and, under the pressure of speculative excitement thus engendered, the States were forced to undertake business enterprises upon the basis of borrowed money.

This period of excitement will receive detailed attention in the following chapter; for the present is it adequate to notice that public banking and public improvements left upon the States a burden of debt from which many of them only escaped through financial disgrace. The amount of this debt in 1842, as also its character and residence, is shown by the figures in the following table:

Table showing the amount of debt resting upon the States in 1842, and the purposes for which it was incurred.

	Public and internal improvements.	Banking.	Miscellaneous.	Total.
Maine . . . . .	.....	.....	.....	\$1,734,861
Massachusetts	\$4,105,000	.....	\$1,819,187	5,424,137
New York	21,727,267	.....	70,000	21,797,267
Pennsylvania	81,186,130	.....	5,149,914	86,338,044
Maryland	14,098,854	.....	1,115,907	15,214,761
Virginia	6,193,161	\$458,107	348,039	6,994,307
South Carolina	8,350,000	187,704	2,208,530	8,691,234
Georgia	1,809,750	.....	.....	1,809,750
Alabama . . . . .	.....	15,400,000	.....	15,400,000 ¹
Louisiana	1,200,000	20,200,000	2,585,000 ²	23,985,500
Mississippi ³ . . . . .	.....	7,000,000	.....	7,000,000
Arkansas . . . . .	.....	2,676,000	.....	2,676,000
Kentucky	8,085,000	.....	.....	8,085,000
Tennessee	1,198,166	2,000,000	.....	3,198,166
Michigan	5,420,000	.....	191,000	5,611,000
Ohio	10,924,128	.....	.....	10,924,128
Indiana	11,751,000	1,000,000	.....	12,751,000
Illinois	10,371,294	8,084,998	121,000	18,527,292
Missouri	20,000	889,261	433,000	842,261
Territory of Florida . . . . .	.....	8,900,000	100,000	4,000,000
District of Columbia . . . . .	.....	.....	.....	1,316,080

¹ Of this amount, \$5,000,000 are liabilities, the remainder direct indebtedness.

² Of this amount, \$2,000,000 was loaned to a planters' association.

³ No public works authorized, but dividends on bank stock were assigned to internal improvements and education.

From the facts which this table displays, it appears that the cotton- and tobacco-growing States expressed a decided preference for public banking, while the grain- and metal-bearing States favored the building of canals and railroads. One may not, however, on this account, conclude that public sentiment in the North respecting banking questions was more highly educated than in the South, for the fact is that during this period the people of the North were provided with all the paper money they could desire. The Southern States did not so strongly feel the need of railroads and canals, for the nature of their produce, and the character of their industrial society, did not suggest the necessity of rapid inland communication. They regarded it as much more desirable to furnish the planter with "capital" for the adoption of better methods in the culture of cotton, and to this end they established banks, or guaranteed the payment of notes issued by private associations. On the other hand, the great majority of the Northern States seem to have been completely mastered by the enthusiasm for public improvements. New York led the way by building the Erie Canal, and Pennsylvania and Maryland quickly followed, in order to protect their local interests. The lake States, also, desiring to avail themselves of the benefits arising from direct communication with the Atlantic seaboard, and to open all parts of their territory to rapid settlement, adopted a similar policy. Other States, as, for example, Kentucky and Tennessee, having no need for either cotton-banks or canals, but being influenced by the general enthusiasm for public improvements, set about building turnpikes and toll-roads.

It appears, then, that the debts contracted by the States between 1830 and 1850 differ somewhat from those considered in the former part of this essay. Not only were the bonds issued for a different purpose, but it was supposed that they would rest for their extinction upon a different fund; and from this it must follow that the rules appropriate to the management of the Federal Treasury do not apply in all strictness to local financing.

Since 1850, the history of the treasury operations of the States presents little of importance to the student of finance. The amount of their indebtedness, less sinking-fund accumulations, was, in 1880, as follows:

Eastern States.....	\$35,207,482
Middle States.....	37,575,110
Southern States.....	123,803,285
Western States.....	37,671,256
Pacific States ¹	170,178

Taking into consideration what we know of the relative wealth of the sections here represented, it appears that the only considerable sum of debt lies upon the Southern States, nor is this so large but that the entire amount might be wiped out by a moderate taxing-policy vigorously applied. This debt was created for the most part during a period of bad government.

The general fact with regard to the States seems to be that, at the present time, they possess no financial standing. They never appear upon the market as borrowers of large amounts of capital, for their administrative activity has been so restricted as to render this unnecessary. Duties which they once performed have passed either to the Federal government, as in the case of banking, or to private corporations, as in the case of railroads. The questions of organization and administration suggested by this state of affairs are certainly of importance, and all that follows bearing upon the history of local indebtedness may be regarded as leading to their solution.

If now our attention be turned to the cities and minor civil divisions, the same necessity for special and detailed study will present itself. The purposes for which municipalities have employed their public credit are peculiar to the position which they hold in the general structure of government, and the rules by which their treasuries should be managed are shaped by the peculiar duties imposed. The totals of local indebtedness for certain significant years are

¹ Porter's "Special Report on Public Debts," p. 522.

given in the table below. The States, which began to assume obligations in 1830, found themselves most heavily burdened, wealth and population being taken into the account, in 1842; but at this date the cities were comparatively free from debt, while the minor civil divisions had not yet made such use of their public credit as to attract general attention. For the year 1880, the amounts presented in the tables are net indebtedness; for the previous dates no such careful estimate has been made to secure accuracy of statement. It is further necessary to notice that for the years 1870 and 1880 the debt of townships and school-districts is included under the heading of city obligations.

Table showing the relative growth of State and municipal debts.¹

	1842.	1870.	1880.
State debts.....	\$198,800,000	\$352,800,000	\$284,450,000
City debts.....	27,500,000	328,950,000	698,970,000
County debt.....	.....	187,500,000	128,870,000

The important feature of this table is the change in the balance of indebtedness which its figures portray. While the States have in large measure retired from the market as borrowers of money, the municipalities have increased the frequency and extent of their demands. It is true that the total per capita debt of both together was not as large in 1880 as in 1870, being \$23 in the earlier period, and \$21 in the latter, but the proportion of this sum for which the cities are responsible is greatly increased.

But for what purposes did the municipal corporations incur their obligations? For an answer to this inquiry we are obliged to rely upon data furnished by the Census Report of 1880. The facts desired are not there given, but it is possible to arrive at substantially accurate results by means of a simple calculation from the figures furnished. The figures,

¹ Porter's "Special Report on Public Debts," p. 27.

upon which this calculation proceeds, as well as the results derived, are presented in the following table:

Table showing amount of bonded debt in 1880, for States, cities, and minor civil divisions, and purposes for which bonds were issued.¹

PURPOSE FOR WHICH LOCAL DEBTS WERE CONTRACTED.	State and local indebtedness, as given in census of 1880.	Indebtedness of cities with population of 7,000 and upward, as given in census of 1880.	Indebtedness of States, as computed from balance-sheets of States.	Indebtedness of towns and minor civil divisions, computed from the foregoing.
Bridges.....	\$24,853,388	\$20,909,481	.....	\$4,048,957
Cemeteries.....	282,816	272,912	.....	10,904
Fire department.....	2,514,082	2,314,924	.....	299,158
Public parks.....	40,612,536	40,490,636	.....	121,900
Sewerage.....	21,370,536	21,335,434	.....	35,102
Streets.....	86,674,860	81,502,817	.....	5,172,048
Water-works.....	146,428,565	141,797,928	.....	4,625,787
Bounties, militia, war.....	76,154,400	28,722,787	\$38,810,788	18,120,875
Funding of floating debts.....	153,949,095	122,864,804	2,978,048	28,106,248
Refunding old debt.....	188,748,780	71,071,140	57,057,882	10,614,728
Public buildings.....	48,493,952	28,516,829	6,827,780	16,649,848
Railroads.....	165,688,948	68,309,493	47,984,090	69,845,865
Canals, rivers, water-power.....	86,924,548	16,726,064	8,655,780	10,842,704
Schools and libraries.....	26,509,457	18,889,915	.....	12,619,542
Miscellaneous.....	180,874,758	26,571,446	90,000,000	18,808,812
Total.....	\$1,117,821,671	\$682,096,460	\$246,814,998	\$189,410,918

There are many significant items in the foregoing table. For example, the assistance granted to railroads suggests a line of study that demands a comprehensive investigation of the entire subject of internal improvements in the United States. Another point of interest is the excessive use made by municipalities of floating obligations. Cities have no business to create floating debts, and yet over \$150,000,000 of their obligations are traceable to this source.² Or, reverting again to the question of the balance of indebtedness, the

¹ This table is compiled from Porter's "Special Report upon Public Debts"; and on this account its figures are slightly different from those found in the seventh volume of the Tenth Census.

² This includes \$28,000,000 of debt yet afloat.

foregoing table shows that the employment of credit by the larger cities is greatly in excess of its use by the minor civil divisions. There are in the United States some three hundred first-class cities, containing about one-fourth of the total population of the country; but their indebtedness is \$682,000,000 as against \$189,000,000 borne by the other municipal corporations. These are indeed startling figures and, when understood, disclose certain dangerous tendencies in the development of local administration; but since it is the purpose of the remainder of this treatise to interpret the facts thus disclosed, we need not dwell longer upon them at the present time.

Comparison of the Rules of Local and National Deficit Financiering.

It remains to inquire how far the general principles of national financiering may be followed in the administration of local affairs. It is quite clear that these principles must be subject to some modification, for rules of deficit financiering spring in large measure from the conditions under which debts are contracted, and these conditions are shaped by the purposes for which appeal is had to credit. From a survey of the items mentioned in the foregoing table, it seems that the debts resting upon the cities and minor civil divisions are capable of a three-fold classification. In the first class are included those debts incurred for the purpose of rendering a direct though a general service to the public. The building of highways; the maintenance of a fire department; the construction of sewerage, and the like, are examples of such services. The second class includes those debts incurred for the purpose of rendering a direct service to the public, but of a particular rather than a general character. This division comprises such services as the supply of water, or gas, or heat, to the citizens of a municipal corporation. The purchase of cemetery-grounds for resale to individuals would also be included in this class. The third kind of local indebtedness arises when the governing body employs its pub-

lic credit for granting assistance to private corporations, believing thereby to serve the public indirectly through the industries established.

All of these classes of debts have certain characteristics in common which distinguish them from debts contracted for national purposes. One important point of contrast pertains to the nature of the demands for which money is borrowed. When the Federal government appears upon the market, the demand for increased revenue is usually sudden and extensive, and of such a sort that no safe estimate can be made of the amount needed. This is not true in the case of the minor civil divisions. Local financing is entered upon with foresight, and not under the stress of any emergency. It follows from this that common business maxims may be more closely observed, and general political and industrial considerations less strenuously regarded. A local council partakes more nearly of the character of the governing board of a corporation than is the case with the Cabinet of the Federal government. For similar reasons, also, the defense of local debts is different from that of national debts. A city or a town can not possibly urge the plea of imperative necessity. It is true that some great disaster, as fire or flood, may incline the local authorities to render immediate assistance to those citizens who are subjects of misfortune; but this desire can not be reflected in the record of indebtedness, since bonds issued for such purposes would be held invalid by the courts. The only defense of local borrowing rests upon the common-sense principle of payment by installments. A revenue law that makes sudden and rapid changes in the rates of taxation is the occasion of unnecessary inconvenience and vexation, and, notwithstanding the rise of extraordinary demands, the evils attending such arbitrary changes may be easily avoided by a resort to credit. If, for example, a court-house or a city-hall is to be erected, it is of common advantage that the people who are called upon to foot the bills should be permitted to distribute their contributions over several years.

A further distinction is suggested when it is noticed that the national financier is forbidden to calculate upon any income that may arise from the manner in which the proceeds of a loan may be expended, and that he is in consequence obliged to rely upon taxes for the support of the debt.¹ But in contrast with this, it frequently occurs that local authorities undertake productive industries and derive a steady income from the investment of moneys borrowed. Thus, the proceeds of a loan are said to be spent for remunerative purposes when invested in such a manner as to render direct personal service to citizens. The furnishing of gas, or of water, or of heat, are illustrations of such services. In cases of this sort, the burden of debt is thrown upon the public industry which its proceeds establish, and its support and final payment are assumed to rest with those who are benefited by the service in proportion to the benefit received. For example, it is the common practice for water-works to be supported by water-rates; and it conforms fully to the requirements of finance that these rates should be so adjusted as to pay for the plant independently of taxation, except so far

¹ The query may arise if bonds issued for territorial purchases do not form an exception to this statement. Why may not land-bonds be provided for out of the proceeds of the sale of land? This might be possible under some circumstances. If the land were already under cultivation, or if the government should purchase it with a view of going into the business of forestry, it might be desirable to pay the debt created out of the proceeds of the property; but according to the land policy adopted in the United States, the financier is forbidden such calculations. Indeed, a loan for the purpose of purchasing large tracts of wild, uncultivated land must primarily rest upon taxes, because such land can only be sold as they are gradually absorbed by advancing population. The treasury figures show this to have been true in the case of the Louisiana purchase. The total amount of six-per-cent stock which it was found necessary to create for payment to France was \$11,250,000 [Bayley's "National Loans," p. 120]. This stock was issued in 1804. Payment upon it was begun in 1812, and, with the exception of about \$8,000, the entire debt was expunged in 1821. If now a date as late as 1825 be taken, it appears that the total gross revenue from sale of lands lying within the French cession was, but \$2,286,220 [Johnson's "Report on the Relief of the States," p. 324]. There seems to have been no difference, then, so far as taxes are concerned, between this financial operation and the borrowing of money for purposes of war.

as the city is itself a consumer. Such a method of treasury management, which leads to the assignment of specific funds to specific services, is not common in national financing. But in local affairs, the principle thus disclosed is one of wide application, and modifies in a marked degree the general rules for the administration of local debts.

Passing, however, from such general distinctions, one may easily observe certain technical differences in the administration of a local and a national debt, arising from the varying conditions under which credit is employed. The most important of these pertain to the use of sinking-funds, tax-loans, and floating debts, as well as to those measures which make provision for the future conversion of public funds. Those rules peculiar to local financing thus suggested are as follows. The administrator of local finances is permitted to found a sinking-fund at the time of issuing bonds, a permission, it will be remembered, contrary to sound rules of national financing. The same may be said of the employment of tax-loans, although the reasons against the use of such obligations by a Federal financier are not so strong as in the case of sinking-funds. Temporary debts, on the other hand, are regarded as necessary for governments imposed with the duty of carrying through a war, or of meeting sudden fiscal emergencies; but in local affairs there is nothing which testifies so unmistakably to fiscal incapacity as the existence of large floating debts. And, lastly, the thought of an ultimate conversion of the funds, which may properly influence the drawing of a Federal contract, can modify but slightly the form of municipal bonds.

All these rules spring from the fact that the purposes for which local governments may properly contract debts do not demand obligations running for a long series of years. It is of even greater importance for the municipal than for the national administrators to remember that public credit is simply a means for anticipating clear revenue. The principles of perpetual indebtedness may properly give direction to a Federal policy, because the extent of extraordinary Federal

demands is frequently uncertain, and the time of their occurrence is altogether beyond the control of the government; but in local concerns, the occasion for resort to public credit is wholly a matter of choice, and reliance may be had upon calculations of expenditure and upon estimates of income. It is this fact that modifies the general rules of finance when credit is employed by the officials of minor civil divisions. Let us consider this more closely.

The attachment of a sinking-fund, for example, to a loan-bill, when the proceeds of the loan are to be expended for war purposes, is useless, to say the least, because the extent of the demand can not, from the nature of the case, be known. Such a procedure involves the absurdity of borrowing money with which to pay an old debt, while yet under the necessity of employing credit to meet new expenditure. But in local affairs, early provision for the payment of a debt is evidence of sound business principles. All the facts bearing upon the question are known to the authorities when they determine to borrow money, and there is consequently no reason why they should not make adequate provision for expunging a debt at the time it is created. This may be the more readily recognized if we call to mind the three conflicting interests which may be harmonized by the employment of local credit.

The first of these is the engineering interest, which demands that public works once begun should be carried on as rapidly as possible to their completion, and this can only be done by assured control over a large sum of money. The second is the financial interest, which regards it as essential that tax-rates shall not be subject to sudden fluctuations. The third is what may be termed the general social interest, which stands opposed to the perpetuation of local debts. So far as the first two of these interests are concerned, the attachment of a sinking-fund clause to a debt-contract is of no particular importance; but since quick and certain payment is demanded by considerations of general welfare, and since neither the engineer nor the tax-assessor can object to an early provision for payment, such provision must be accepted

as an essential requirement for the management of a local debt. The same line of argument might be used with regard to tax-loans, a form of credit that can not be employed in any marked degree when the extent of extraordinary demands may not be estimated with safety. Indeed, there is no difference in principle between a tax-loan and a loan with a sinking-fund attachment.

There is also an additional reason why a law authorizing the issue of local bonds should contain a provision for the establishment of a sinking-fund. It will be remembered that cities and minor civil divisions are inferior and dependent governments, and that their officers are subject to the jurisdiction of the courts to the extent that laws which exist must be executed. If now a sinking-fund be created by the law that creates the debt, a public creditor has an assured and an easy method of securing payment upon valid obligations. It does not follow that the creditor would always enforce his right should the sinking-fund payments be passed, but the fact that it lies within his power to do so gives an additional value to the obligations, and consequently an additional advantage to the municipality in the placement of its bonds. This consideration does not apply to the Federal government, nor at the present time to the State governments, because they are both sovereign for debt purposes, and the only security which it is possible for their bonds to offer is the good will of their legislative bodies.

The general evils attending an excessive use of floating obligations have been already pointed out, and it is only necessary to add, in this connection, that the alternatives which sometimes demand their employment by the national financier can never arise for local administrators. The only defense of a floating debt is the fact that an administration is surprised with sudden demands which can not wait the sale of ordinary obligations; but such a surprise can not present itself to the local financier, who himself determines the occasion and extent of fiscal demands. As has been frequently remarked, local financiers have nothing to do with emergen-

cies. Still, one can not conclude from this that city and county warrants, certificates of indebtedness, and such like temporary paper, should never be employed. Such instruments of credit may or may not constitute a floating debt, according as they are or are not assigned to some assured revenue. If a definite amount of clear income be appropriated to their payment, common warrants are properly classed as tax-loans and not as floating debts, and their convenience in treasury administration commends their use. That which is here condemned is that looseness, so frequently to be observed in the management of city accounts, which leads to the settlement of claims by the issue of warrants and certificates. The funding of such paper must come sooner or later, and the city that thus postpones the liquidation of its accounts is sure to become embarrassed.

It follows, likewise, from the reasons already given, that the policy of local indebtedness need not be shaped with a view to ultimate conversion. Conversion of a public debt means such a modification of the contract as to secure, before its final payment, more favorable terms than those originally entered into. In the case of national financing this is of great importance, because the conditions under which money is borrowed are commonly such that the government is obliged to accede to severe terms. A state of war, for example, is unfortunate for the borrowing of money, and without any change whatever in the industrial relations, the return of peace will give a government control over capital at cheaper rates than it was obliged to pay during the continuance of hostilities. But this can not apply to local financing, for a local government is at liberty to select the most opportune times for the sale of its bonds, and consequently it need never suffer the expense of high rates of interest to overcome the risk of investment. So far as the rate of interest is dependent upon risk, a municipal council may censure itself if that rate be not as low when a debt is created as after several years shall have elapsed.

Again, in the administration of national affairs, it may be

necessary to contract a debt of such magnitude that it can not be expunged before the natural development of commercial relations shall have reduced the rate for which money may be secured; and from this it follows that the thought of ultimate conversion should be always kept prominently in view. But this reasoning can not apply to local borrowing, for local debts should never cover periods so extended that industrial changes can materially modify the value of money while specific obligations continue to run. The purposes for which municipalities borrow do not require that their obligations should long remain in the hands of creditors. It may be that those conditions justifying an appeal to credit will constantly recur in the course of local administration, so that the local government will not be freed from debt for a long series of years; but it will be a debt constantly in course of expungement, and in this manner whatever advantage arises from a gradual fall in the rate of interest can be secured to municipalities. In local financing, new borrowing secures money for new purposes, while existing taxes expunge old debts; in national financing, conversion implies the employment of fresh credit in order to pay off existing debt for the purpose of obtaining better terms—but in either case the governing bodies reap an advantage from constantly falling interest.

The accuracy of what has been said may, perhaps, be more clearly discerned in the reflected light of another distinction. Those considerations that determine the time at which the payment of debts should begin, as also the rate at which it should proceed, are quite different for national and local financing. The point at which the two policies diverge is, that in the one case money is borrowed for general and in the other for particular purposes. When a debt is contracted for a general purpose, as is the case in time of war, it is conceived to rest upon the combined industries of the country, and questions pertaining to payment are determined by the state of trade. This subject has been already discussed in a foregoing chapter. Most local debts, on the

other hand, are contracted for some definite purpose, and their proceeds are employed in such a manner as to establish in the community some particular form of public service ; it is natural, therefore, that the expungement of a local debt should conform to the manner in which its funds were invested. As an illustration, suppose capital to be borrowed for the purpose of paving streets or of providing sewerage, the service thus rendered is common to all members of the community, but of such a nature that the debt must rest upon taxes. But what is of yet more importance, the local council can not proceed as though the city would never be called upon to repeat its expenditure, for pavements and sewerage are subject to wear, and must sooner or later be replaced by new systems. From this it must appear that the payment of a local debt is not to be determined by the general industrial conditions of the country, but that sound policy demands the expungement of existing obligations before the public authorities find it necessary to borrow fresh capital for new improvements. It seems, then, that the rapidity with which such payments should be made depends upon the probable life of the pavement or the sewerage, and this is a question that must be determined by the city engineer.

Similar reasoning applies, only in a more marked degree, if the proceeds of a debt are employed to establish remunerative public works, for in such a case the income from the public industry established is supposed to support the debt. With regard to gas-works and water-works, for example, general business rules may be appropriately applied for the reimbursement of capital sunk. Such debts should be paid as rapidly as the interests of consumers will bear, so that the property may become an unincumbered property to the community. There are other conditions, however, in which these rules of payment may be somewhat modified. In the case of purchasing real estate for public parks, or of lending assistance to railroads or other private enterprises, the policy that should direct a local treasury is more nearly akin to that

followed by the national financier. The reason is that these measures are conceived to be exceptional rather than constantly recurring. The real estate of a park, which at first may cost a large sum of money, is an investment the value of which is not depreciated by time and use; the benefits supposed to arise from enlarged commercial facilities are also of a permanent nature. It follows that the payment of such debts may properly extend over a longer period, and for two reasons. The fact that the investment is permanent obviates the necessity of clearing accounts before a similar expenditure of fresh money is required. But of more importance is the demand that the rate of taxation shall not be changed with unnecessary rapidity. If, for example, it were undertaken to pay for a park purchased in four or five years, there would be an unnecessary burden entailed upon the community, first, by the rapid rise in tax-rates, and second, by the rapid fall in tax-rates after the payment had been accomplished. It is true that this is not of so much importance in local taxation, where impositions are for the most part direct, as in the case of Federal taxes, where reliance is had upon indirect contributions; but it yet applies, and from it one may conclude that a two- or a three-per-cent sinking-fund provides for the extinction of such debts with sufficient rapidity.

It has been the purpose of the present chapter to clear the ground for an historical study of local indebtedness in the United States. By means of the analysis which it presents, we have discovered the relations that exist between the various grades of government and the legal character of the bonds which they respectively issue. We have learned, also, how the burden of indebtedness has been shifted as the relative importance of these governmental centers has changed, and from this the natural classification of our further study has been suggested. In the third place, our analysis has brought prominently into view the essential differences that exist between the employment of public credit for local and for national purposes, so far as these are trace-

able to the peculiar duties imposed upon the inferior governments and to the conditions under which they are obliged to perform them. From this point, then, we may proceed to consider the facts of local indebtedness more in detail, and to study such practical questions as may be suggested.

CHAPTER II.

STATE INDEBTEDNESS BETWEEN 1830 AND 1850.

WERE it our purpose to present a complete historical explanation of the course of indebtedness on the part of the American commonwealths, it would be necessary to consider at some length the assumption of State debts by the Federal government in 1790. The experience of the States from 1830 to 1850 was quite different from what it would have been had they not been relieved by Congress from the necessity of providing for their obligations incurred during the Revolutionary War. But so closely intertwined is the influence of this historical fact with other political tendencies working in the same direction, that it would be difficult to trace the causal relation thus suggested. Nor does this seem necessary to our present purpose. Accepting the position of the commonwealths in 1830 as an established fact, and their rights against the Federal government as well understood, their subsequent financial history is fully adequate to explain why at the present time they have no financial standing ; and why, in the struggle shortly to be renewed between centralized power and local government, the commonwealths find themselves handicapped with certain constitutional restrictions which their citizens have unwisely imposed. It is, then, this second period of State indebtedness that will serve as the more fruitful subject of study.

After the assumption by the Federal government of their local obligations in 1790, the States, as political sovereignties, made no extensive use of public credit previous to 1820 ; nor

was it until some twelve or fifteen years later that they appealed extensively to this source of revenue. How extensive this appeal came finally to be, appears from the figures which show the growth of local debts. During the ten years following 1820, public stocks were authorized in the various States to the amount of \$26,000,000, of which nearly \$18,000,000 were held against the three States, New York, Pennsylvania, and Ohio. Between the years 1830 and 1835 \$40,000,000 more were added to the obligations of the States, while the three years previous to 1838 witnessed an increase of local indebtedness to the amount of \$107,000,000. The total liabilities resting upon the States in the year 1843, including both direct and floating debts, and loans of credit, reached the sum of \$231,600,000. These figures, it is true, may not appear large at the present time, accustomed as we are to speak and think in billions; but at that day, before the system of public debts had been generally developed, they excited the alarm of all citizens.

The purpose for which the States employed their public credit has been suggested in a previous chapter. Canals and railroads claimed the attention of the North; turnpikes and banks flourished in the South. The popular enthusiasm for "modern progress" led to speculative enterprises of all sorts.¹ Grand projects for internal improvements far in advance of the immediate needs of the country were set on foot. It was not for a moment thought that the debts thus created would be the occasion for an increase of the tax-levy, and when, the means of the States exhausted, it was discovered that the moneys borrowed must be paid out of ordinary revenue, the public was filled with consternation. The population of the country in 1843 was about seventeen millions,

¹ An American comedy, published in 1846, entitled "Antipathies; or, the Enthusiasts by the Ears," draws an amusing picture of the times. Among the characters are *Jacob Changeless*, a mortal enemy of modern improvements; *John Progress*, an infinite perfectibility man; and *Elihu Go-ahead*, a mighty projector of railways and all internal improvements.—"American Comedies," by J. K. Paulding, Philadelphia, 1846.

while the annual interest charges arising from State debts was \$12,250,606. It was then that the word "repudiation" crept into the financial vocabulary of the American people. The reputation of the country abroad also seriously suffered. "America," says a writer in the "London Times," "is not the country it is cracked up to be; too many speculators and gamblers—indeed, to be plain, I look upon it, from Maine to Florida, as one vast swindling shop."¹

It must, however, be remembered that a swindler is impossible without some one who is willing to take the risk of being swindled. A period of expanding credit means eagerness to lend as well as eagerness to borrow. If, then, we would understand the period which now claims our attention, so as to draw from it the true lessons it teaches, we must at the outset undertake to discover the source of that confidence granted without hesitation to the States.

In following out the line of study thus suggested, the first fact of importance is neither financial nor industrial, but political. The year 1830, which marks the rise of borrowing among the States, witnessed the reversal of certain political tendencies which, up to that time, had been maintained in national affairs. Democracy was in the ascendancy, and many measures were adopted by the dominant party, the purpose of which was to weaken the administrative power of the central government. As a subordinate part of this policy the States were imposed with new duties, and it was through their ready response to the demands made upon them that they became financially embarrassed.

This change in the political purpose of the American people may be clearly seen if we trace the notion of local government as it appears in the development of national affairs. Political parties in this country arose out of a controversy respecting the adoption of the Constitution. The question in dispute pertained to the nature of that instrument. Was

¹ Quoted from a pamphlet of 1840, entitled, "A Vindication of Public Faith of New York and Pennsylvania in reply to the Calumnies of the 'Times,'" p. 24.

it national or federal in its character? Would it ultimately result in the establishment of an empire or of a republic? The story of the manner in which the national party came to assume the name of "Federalists" is interesting, because it shows what must have been the ruling sentiment of the people in 1788 and 1789. It was tacitly admitted that an anti-federal Constitution could not be adopted. At first, they who opposed the Constitution called themselves Federalists, as showing the ground of their opposition to the proposed government; but their opponents quickly saw the strength of such a position and the power of such a party cry, and, with true strategic insight, determined to capture the name.¹ The controversy, at least in the State of New York, centered in the question as to which faction truly represented the federal idea. The result is familiar. The "anti-adoptionists" were driven from their stronghold. They first assumed the name of Federal Republicans, and then of Republicans; and it is this party which is the historical progenitor of both Jeffersonian and Jacksonian Democracy.

The first two administrations were guided by those statesmen who had persuaded the people to accept the Constitution; and being controlled by the purpose of extending the duties and functions of the central government, they necessarily lent their influence to the consolidation of power. This was so apparent that it gave rise to grave apprehensions among those who were jealous of local rights, and it was by means of this jealousy that the Republicans raised themselves to office in 1801. There was, however, no marked change in the administrations that followed. Such was the condition of foreign affairs that the Republicans were unable to redeem their campaign pledges and restore to the States any of their lost importance.

It is true that internal duties were abolished,² but on the other hand the purchase of Louisiana showed the trend of

¹ Leake's "Life and Times of General John Lamb," pp. 305 and 306.

² It is a significant fact that Gallatin refused to formally propose the abolition of internal duties. This proposal came from John Randolph as chairman

events toward nationality to be stronger than the avowed purpose of the party. Then came the war of 1812 and the establishment of the American system of protection, both of which events worked to the detriment of the States and increased the relative importance of the central government. During the years that followed the second war, say from 1818 to 1828, the manifest tendency toward centralization was the occasion of grave apprehension, and gave rise to two quite distinct lines of opposition. These found expression in the metaphysical doctrines of Calhoun on the one hand, and in the practical measures of Jackson's domestic policy on the other. It is with this latter that we are especially concerned, for it was in harmony with Jacksonian ideas that the States again became the centers of administrative activity.

The policy of decentralization adopted about 1830 was extremely simple. The Federal government withdrew from certain duties which it had previously performed, and refused to take upon itself new tasks which quite a respectable minority of the American people sought to impose upon it; and it was in this manner that the States, after an uneventful existence of more than forty years, again became the centers of important administrative measures. In our day private corporations compete with governmental agencies for the administration of great affairs, but at that time private enterprise was not thought to be adequate to meet the demands of the public for internal improvements. The States were thus forced into a prominent position.

It would lead us too far from our purpose to speak at length of the various parts of Jackson's domestic policy, nor does this seem to be necessary. It is only important that we clearly see how the Federal government rolled certain duties from off its own shoulders on to those of the States, and this may be the best perceived by tracing the development of the idea of internal improvements.

of the Committee of Ways and Means, after he had received assurance from the Secretaries of War and Navy that their departments could be administered with greater economy.

The original incentive to the development of inland communication was political and not commercial. Washington clearly saw at an early day that a country of such vast extent and variety of territory as that ceded by Great Britain could not be held together except by community of interests between the various sections, and that this community of interest could only spring from easy and continuous commercial intercourse. His own words will show how strongly he felt on this point :

I need not remark to you [wrote he to Governor Harrison, of Virginia], that the flanks and rear of the United States are possessed by other powers, and formidable ones, too ; and how necessary it is to apply the cement of interest to bind all parts of the Union together by indissoluble bonds, especially that part of it, which lies immediately west of us, with the middle States. For what ties, let me ask, have we upon the people (in the Mississippi Valley) ? How entirely unconnected with them shall we be, and what troubles may we not apprehend, if the Spaniards on their right, and Great Britain on their left, instead of throwing stumbling blocks in their way, as they now do, should hold out lures for their trade and alliance ? What, when they gain strength, which will be sooner than most people conceive (from the emigration of foreigners, who will have no particular predilection for us, as well as the removal of our own citizens), will be the consequences of their having formed close connections with either or both of these powers, in a commercial way ? It needs not, in my opinion, the gift of prophecy to foretell.¹

The Western States, he went on to say "hang on a pivot," and to turn their thoughts eastward rather than southward, he proposed that easy means of communication be provided between the two sides of the Appalachian Mountains.

It is quite natural that the conception of public improvements which sprang from the idea of nationality should find ready acceptance with men infused with national sentiments. Even the plan which Gallatin presented in 1807,² according to which \$20,000,000 were to be maintained as a revolving

¹ Sparks's edition of "Writings of Washington," vol. ix, p. 62.

² State Papers, "Miscellaneous Documents," vol. i, p. 724.

fund for building highways of commerce, was, to say the least, far-reaching in its tendencies, although it was thought to be in perfect harmony with the recognized rights of the States. During the years previous to 1830, it will be remembered that one of the great questions of national policy was the building of canals and wagon-roads. A national board of internal improvements was established; national surveys were carried on; and, had not certain questions that imperiled the general safety forced themselves upon public attention, we should now have been able to write the experience of national improvements actually undertaken. According to Benton, "the candidates for the presidency spread their sails upon the ocean of internal improvements."¹ As early as 1822, when Monroe placed his veto upon the Cumberland-Road bill, the sentiment favoring internal improvements was general, and became more intense through the administration of John Quincy Adams.

Although the right to construct highways of commerce was quite generally conceded to Congress, there were many who denied the constitutionality of placing Federal officials over such works when completed. Many who were friendly to the policy refused to support congressional action looking toward its realization. This was the burden of President Monroe's veto of the Cumberland-Road bill in 1822.

It is of the highest importance [he says] that this question be settled. (That is, the question as to whether Congress had the right to manage roads running through the States). If the right exists, it ought forthwith to be exercised. If it does not, surely those who are friends to the power ought to unite to recommend an amendment to obtain it.

The policy of national improvements broke down under President Jackson's veto of the Maysville-Road bill. This message brought again into prominence the old idea respecting the proper residence of public authority. The programme adopted did not permit the Federal government

¹ Benton's "Thirty Years," vol. i, p. 22.

any control over questions of internal policy; it was conceived that the States should manage all such matters.

Now, to my mind, it is of some importance that this relation between what may be termed the national and the local theory of internal improvements be clearly recognized, for then only can one understand the unbounded enthusiasm with which the local governments went into the business of supplying the country with canals and roads.¹ This enthusiasm had grown up under the fostering care of the Federal power. Its purposes had been thwarted because Congress did not possess the legal right to manage roads within the boundaries of a State. But the people, caring more for the end than the method of its attainment, presented their demands to the local governments. In this manner it was that the legislatures of States assumed the duties abandoned by Congress, having received, by bequest, as it were, the duty to fulfill the wishes of the people which had for so many years been encouraged by the central government.²

The change of policy about 1830, here referred to, was recognized by those who had to do with shaping public affairs. The Hon. Charles Francis Adams, writing in 1840, upon State debts, says :

¹ "The strength as well as the true glory of the Confederacy is founded on the prosperity and power of the several independent sovereignties of which it is composed, and the certainty with which they can be brought into successful, active co-operation through the agency of the Federal government."—Jackson's Message of 1830.

Speaking of the manner in which the law for the distribution of the surplus revenue was interpreted by the States, Mr Johnson says: "The States conformed to what they were led to believe was the new policy of the Government, and, in anticipation of its continued aid, laid down plans of railroads and canals, and both or all parties rivaled each other in projecting intercommunications, in the belief that they would develop the resources and advance the prosperity of their States."—"Report on the Relief of the States," p. 513.

² To avoid any possible misunderstanding, it may be well to say that Congress has had to do with internal improvements since 1830, but not with any public works from which revenue could be derived, where Federal and State authority might come into conflict. Federal assistance has been rendered either by direct payment of money to the States, or by what have now come to be known as river and harbor appropriations.

The Americans are proverbial for never being discouraged. If they can not carry a point directly, they will manage to do it by some roundabout way. They were determined upon improving the communications between the seaboard and the interior. A very large number of them thought it best that this work should be done under the superintendence of a common head, and they proposed a method of action accordingly. But the extent of it excited the apprehensions of a still greater number, and they refused to adopt it. According to them, the business could be intrusted with safety only to the care of the separate States upon whom it was in the end devolved. The consequence has been the outlay of quite as much money, if not a great deal more, than would have been expended on the other plan.¹

It will not be necessary for us to trace the development of this policy of internal improvements in the various local centers. Sufficient is it to say that the States, as a rule, entered upon the work of supplying public highways with an unbounded enthusiasm, and projected schemes absolutely absurd in their magnificent extravagance. But since specific illustration is worth many general statements, I venture to present the plan as it was adopted by the legislature of the State of Michigan.

Michigan was admitted into the Union in January, 1837, and it might be imagined, from the proceedings of her early legislatures, that the purpose for which she sought the privileges of a State was to build canals, railroads, and turnpikes, and to improve rivers and harbors. The legislature, in its first session, appointed a "Board of Commissioners on Internal Improvements," and directed them to take the necessary measures for executing the following public works: They were to survey three lines of railroad across the State—called, respectively, the Southern, the Middle, and the Northern routes, and one shorter road, called the Havre Branch Railroad. They were also to undertake three important canals—the Clinton and Kalamazoo, the Saginaw or Northern, and a canal about the St. Mary's River. In addition to this, the Grand, the Kalamazoo, and the St. Joseph rivers were to

¹ "North American Review," vol. li, p. 321.

be improved. The total extent of these works entered upon by the first legislature amounted to 1,100 miles of highway, of which 557 miles were to be railroads, 231 canals, and 321 improvements of rivers. The population of the newly admitted State was at this time 175,000, from which it appears that the legislature projected one mile of improvement for every 150 of the inhabitants, which, upon common averages, gives one mile for every thirty votes. Besides these improvements under the direct control of the State, there were in existence, in 1837, twenty charters to private companies for the building of railroads. The extent of lines proposed by these companies was 930 miles, from which it appears that there were over 2,000 miles of commercial highway projected before the State was a year old, and this estimate does not include turnpikes.¹ Some idea of the appropriateness of these plans may be gained when compared with the amount of railroad facilities which the settled experience of the State shows to be adequate to present demands of commerce. In 1881, with a population of 1,650,000, there were but 3,306 miles of road-bed, being one mile for every 500 inhabitants, or every 100 votes. Certainly Governor Barry was correct when in 1842, referring to this great scheme of internal improvements, he said : "The system, so called, was altogether beyond our means, and, indeed, embraced projects of improvements that were not at the time required by the public good."

Such plans as these, and Michigan was by no means peculiar in her enthusiasm for internal improvements,² do not

¹ Cf. Blois's "Gazetteer of the State of Michigan," 1888, pp. 77-97.

² Much of interest on this subject may be found in "The History of the Surplus Revenue of 1837," a scholarly essay by Mr. Edward G. Bourne. He quotes (p. 126) "from one who lived through the period" as follows: "In 1836 the fever of internal improvements raged throughout most of the States of the Union. Pennsylvania, my native State, was crazy to improve the whole country, whether the wants of the people required it or not. Indiana was almost as wild; and Illinois, also, was crazed considerably by the mania." And the author adds: "The movement had begun in Illinois in 1832, and had rolled on with increasing momentum till 1836, when the law (i. e., the Improvement Bill) was

find adequate explanation in the withdrawal of the Federal government from the direct prosecution of public works. The States undertook to perform the impossible, while the legacy of duty which they received from the central government was moderate and rational. The change of policy in 1830 serves only as the background upon which other facts may be thrown, for there came at this time other forces, partly independent and partly the outgrowth of this new policy of Democracy, with which one must acquaint himself in order to explain fully this second period of local borrowing.

In the first place, the States received direct assistance from the general government in money and lands. Not only did Congress give up all claims of active control in matters of inland commerce, but that body donated also the surplus revenue of the national treasury, and a percentage upon the sales of all lands, to form a fund with which the States could carry out their plans of public works. These moneys formed by no means an insignificant sum. In Michigan, for example, the experience of 1836 gave every reason to hope large things from the fund established. Standing on the verge of the year 1837, those who controlled the policy of this State saw coming into her treasury \$280,000 from surplus revenue, and \$175,000 from her percentage of land-sales. There was no precedent for such extensive sale of lands, and it is not surprising that this young State indulged in dangerous optimism, not distinguishing between purchases for purpose of speculation and for purpose of settlement, and not recognizing that the immense dealings in real estate were one of the results of the pernicious financial policy of the central government. There is no question but that the assistance of the general government, coming at the time when it did, is largely responsible for the carelessness with which local obligations were incurred.

passed. It was not the fault of the politicians, but of the people who clamored for it; the people would not trust their representatives, but sent on delegates to lobby."

But again, the invitation to embark in great public works was especially alluring during the three years previous to 1838, on account of the process of inflation through which the country was passing. With the downfall of the national bank, an era of unsecured paper money ensued. The rapidity with which inferior instruments of exchange grew, upon the reversal of the national policy, may be seen from the following figures, giving the notes in circulation, and the deposits and loans of the banks :

	Circulation.	Deposits.	Loans.
January, 1830.....	\$61,324,000	\$55,560,000	\$300,451,000
“ 1835.....	108,269,495	83,081,000	365,163,000
“ 1836.....	140,801,088	115,104,000	457,506,000
“ 1837.....	149,185,890	127,897,000	525,115,000

This most certainly indicates a period of inflation, and all the results of inflation familiar to the student of economy followed in their most intense form. Values were radically disturbed; fictitious profits were regarded as real, and the apparent success of modest endeavors led men to enter boldly upon great undertakings; land speculation was especially excessive, for it was believed that the "vast West" was to come immediately into the market. It is not too much to say that these were years of business insanity. Cool judgment had for the time lost control, and men acted upon an impulse which they themselves could not afterward understand. The enthusiasm of legislators was merely one of the manifestations of the general enthusiasm of the times. I have collated with some care the enterprises projected by the legislature in one of the Western States, and those set on foot by private parties in the same State, and I do not hesitate to say that, whether judged from the standpoint of results or of business probabilities, the State authorities showed greater foresight and greater business conservatism than did individuals. The intimate relation between an inflated currency and the projected improvements in the State of Michigan is well told by Governor Barry in his message of 1842 :

The conception of the plan on a scale so magnificent [said the governor] is to be attributed to the erroneous opinion of wealth produced by a too redundant paper currency. The system was altogether too extended for our wants, and required expenditures beyond our means. It was projected at a time when things were too often viewed through a distorted vision. Property had assumed fictitious value; national as well as individual revenues were greatly overestimated, and the minds of men had become inflated by imaginary success in the acquirement of wealth. Individuals embarked with confidence in enterprises which they now regard as extravagant and visionary. The spirit of the times, unfortunately, became the governing policy of States, and Michigan, with a population then less than two hundred thousand, inhabiting a territory new and recently settled, with few immediate resources but her credit, projected a system of internal improvements which would have been a grand undertaking for the oldest and most wealthy States.

The third fact upon which reliance is placed for explaining this period of expanding credit is wholly industrial in character.

It is usually the case that a wide-spread enthusiasm for any industrial enterprise is imitative rather than original. This is most certainly true of the period we are now studying. The State of New York must be regarded as the pioneer in matters of public works, and the financial and commercial success of the Erie Canal exerted no slight influence in leading other States to believe that a like success awaited every enterprise. This highway of commerce was finished in 1825. It immediately became a source of revenue, and proved that the statesmen who urged it upon the people were wise counselors. Nor was it alone the final success of the enterprise that worked upon the imagination of other localities, but the accuracy of calculations respecting it also induced men to place great confidence in enterprises similarly managed. In 1826 it was estimated that the debt incurred in building the Erie Canal could be expunged in the course of ten years' operation. The figures upon which the conclusion rested are the following. On the side of receipts, the annual income was:

From tolls.....	\$700,000
From auction sales.....	250,000
From salt duties.....	170,000

Chargeable to the revenue which was applied to canal management, there was :

Interest on the debt.....	\$410,000
Expense of repairs.....	100,000

leaving a yearly appropriation of \$610,000 for the payment of the debt. Upon the basis of these figures, the debt could be discharged in ten years, and the result of the management of the enterprise showed the calculation to be correct within six months. It was, perhaps, the successful management of this New York enterprise, more than any other one thing, that occasioned the outburst of enthusiasm in favor of local improvements.

But there is another fact worthy our attention in connection with the Erie experiment. Previous to the completion of this highway of commerce, the city of New York, like the cities of Boston, Philadelphia, and Baltimore, had been a local village, draining the country naturally dependent upon it ; but, with the completion of the canal, it at once became a port of importance to the entire country west of the Alleghany Mountains and north of the Ohio River. The local interests of Philadelphia and Baltimore were placed in jeopardy, and these cities at once undertook protective measures by pushing vigorously their own schemes for inland commerce. Then began that struggle between the seaboard cities for commercial supremacy over the West, which has become more and more intense even to the present time. The point which I wish to make is this : About 1830, men in the East were for the first time coming to realize the great possibilities of the West, and the rivalry between the various sections of the East to secure to themselves the benefits of the trade which was sure to spring up, induced men in these sections to lend freely to such enterprises as would be of especial advantage to themselves. It was under such encouragement, and because the idea of corporate control had not yet been

sufficiently developed, that the States were led to freely mortgage their sovereign credit for pushing public works.

I have thus endeavored to suggest the active forces which gave character to the years of local control between 1830 and 1840, and it is believed that, taken in their relation to each other, they furnish an adequate explanation of the excessive employment by the States of their sovereign credit. The States borrowed money to build public highways. That public highways should be built was one of the imperative demands of the times. That the States should undertake this work rather than the central government or corporations, was the result of this historical accident—that the call for inland improvements came just when, in the development of political ideas, there had been a reaction against the policy of federal administrative control, and before the doctrine of *laissez-faire* had in this country produced any results except in matters of foreign commerce. The general confidence in the States which led men to place money freely at their disposal, was in part merely an expression of the general confidence of the times; in part an indirect consequence of the easy payment by the Federal government of its debt; and in part because men saw in the public improvements which the States were undertaking an additional advantage beyond that of a mere investment of so much capital. All these forces taken together made up the atmosphere of the times, which, to say the least, proved very invigorating to those who breathed it.

We need not arrest our study at this point to speak of the failure of these schemes of internal improvement. Indebtedness to the amount of \$200,000,000, unsecured by any property adequate to the support of such a burden, is sufficient evidence of failure. Had these enterprises been set on foot by private corporations, they would have passed into the hands of a receiver for the benefit of creditors, but since they had been projected by the States nothing remained but to throw upon taxes the deficits of the business. It was this fact which brought the failure of the policy home to the

people with great force. In Michigan, for example, the rate of taxation for county and State purposes was but seventy cents per capita, while the interest arising from the public improvement debt would have imposed upon the people a tax of one dollar and thirty-five cents per capita had it been paid.¹

It was natural that the States should, under such circumstances, and with the precedent of Revolutionary finances before them, appeal to the Federal government for relief. Petitions to this end came from Virginia, Pennsylvania, Maryland, and Ohio; and we are led to believe from the statements of those interested in the scheme, that other sections would gladly have thrown the burden of their debts upon the shoulders of Congress. The committee to which these petitions were referred proposed that \$200,000,000 of Federal stock should be exchanged for State securities. It was claimed that the legal right of the Federal government to do this had been settled by the assumption act of 1790. The thought that the debts incurred during the Revolutionary War were in reality Federal debts, and for that reason should have been assumed by the Federal government (i. e., the theory of the Federalists in 1790), was not for a moment admitted; and the author of the report of 1842 favoring a second assumption devoted some considerable time in making it clear to his constituents that there was in reality no difference in the two cases. After a somewhat extended review of the early debates, he says:

These facts and this history clearly prove that the assumption was not a matter of constitutional obligation, but of mere legislative discretion, wisely and legally exercised, no doubt, under the general and discretionary powers given to Congress

¹ It would be exceedingly difficult to give a correct and complete account of the subsequent management of the debts resting upon the States in 1842. It was during this period that the word "repudiation" came into the vocabulary of American finance. Should any of my readers be interested in this subject they are referred to a comprehensive article by Mr. Robert P. Porter, on "State Debts and Repudiation," in the November number of the "International Review" for 1880.

under the Constitution. The Constitution is the same now as then ; Congress is the same now as then ; and it can exercise as wise, as enlarged, and as liberal a discretion now as then.¹

But although the assumption of State debts in 1842 was not regarded as "a matter of constitutional obligation," it was urged as a right which the States could demand, in view of the cession of lands which they had made to the central government. It was argued that "the States have a controlling reason to demand the measure, in the fact that *the public lands were never intended, when the Constitution was formed, to be a source of national revenue for the support of the General government.* The States gave to the government *other and abundant means of raising revenue for all its ordinary and extraordinary expenditures.* The States surrendered to the General government the public lands for *their specific benefit.* They made the General government the agent or trustee to dispose of public lands, and to distribute among all the States the product of this trust, upon an equitable and just basis.

"When the General government assumed the debts of the State in 1790, the proceeds of the sales of the public lands were pledged 'until' the liquidation of that debt." Then follows an estimate of the income derived by the Federal government from public lands, which had been appropriated to national purposes, after which the argument continued : "Then the States have a right to demand a re-imbursement, in this period of their utmost need, of this sum used by the government for its own national purposes."²

But it was not with the intention of discussing the claim here set up respecting the interpretation of the old land-cessions that this phase of the question is brought to our attention. It makes little difference how that controversy is decided. The important point for us to notice is, that the plan for assuming the State debts in 1842 finds its historical

¹ "Report on the Relief of the States," p. 486.

² Ibid., p. 516.

antecedent in the various distribution schemes then familiar to the members of Congress. As early as 1826, Mr. Mahlon Dickerson, afterward a member of President Jackson's Cabinet, proposed to divide \$10,000,000 of the general revenues annually among the States. The distribution of surplus revenue in 1836, as also the tariff compromise and the views of States rights which made it a necessity, are well known to every student of American history. But the idea of distribution once established, the payment of surplus revenue to the local governments was not regarded as adequate assistance, and there were many proposals that the proceeds of the public lands should be given to the States to help on their schemes of internal improvements. It was in connection with one of these proposals, and because of an amendment which was thought to kill the spirit of the bill, that the plan for assuming the debts of the States took its rise. The facts in the case are as follows: In 1842, Mr. Clay reported a bill in the Senate to divide the proceeds of the sale of public lands for five years between the States. The chairman of the Committee on Public Lands in the House was William Cost Johnson, of Maryland. Mr. Clay's bill came before this committee, and after several amendments, one of which made the distribution perpetual except in time of war, was passed by the House. But in the Senate an amendment was inserted to the effect that the distribution should be inoperative if, at any time, Congress should levy duties above 20 per cent.

No one [says Mr. Johnson] opposed more earnestly than myself the introduction of such a principle, regarding distribution to be the right of the States by the act of cession, without regard to the rate of duties or the condition of the national revenue.

It was then that he determined to bring the matter of assumption squarely before Congress.

Apprehending [he says], in the conflict of contending interests, to say nothing of rival ambition, that the States would lose the benefit of distribution, I gave notice at an early period

of last session that, at the earliest possible moment after the defeat of distribution, I would introduce a bill, upon the principle and basis of the law of 1790, for the assumption of the debts of the States by the General government.¹

It seemed to me necessary to show the historical setting of the assumption scheme of 1842, in order to bring clearly into view the relations existing between the States and the Federal government. The years immediately following witnessed so violent a change in public sentiment, that they may be properly regarded as marking an epoch in the constitutional development of the States. But before speaking of permanent results, it will be interesting to notice the details of this scheme of assumption, and to consider some of the arguments urged by those who favored it.

Whatever may be said of the policy of assuming local obligations, the plan proposed by the committee which had the matter in charge was both inadequate and expensive. This plan contemplated the issue of \$200,000,000 of United States stock, which should be distributed between the States in the following manner: For each senator there should be allowed \$1,000,000 of this stock, the residue being divided among the States on the basis of Federal population; or, to be more exact, each representative should bring to his State the sum of \$651,982.38. The Territories and the District of Columbia were to receive stock equal to that allowed one representative. It may be remembered that the settlement of inter-State accounts after the Revolutionary War, through the agency of assumption, was rendered impossible by the constitutional rule that all burdens imposed or benefits granted by the central government should be apportioned on the basis of Federal population. The same difficulty is here encountered. Nine States in the Union were wholly free from debt, and, should Federal stock be issued to the delinquent States and not to these, it would result that those States which had been conservative in the management of their finances would be imposed with taxes for the discharge

¹ "Report on the Relief of the States," p. 469.

of their neighbors' debts. To obviate this manifest injustice, it was provided that the States not indebted should have their quota of bonds credited to them on the books of the Treasury, and should be permitted to draw each year the interest accruing upon the amount thus declared to be due.

But upon such a plan as this, to what extent would the indebted States be relieved by an issue of \$200,000,000 of stock? The answer to this question is presented in the following figures:¹

Amount of State debts in 1842.....	\$207,894,618.85
Amount of Federal stock to be issued.....	200,000,000.00
Amount of State debts paid by such issue.....	128,108,917.55
Balance yet due from States.....	79,790,695.80
Balance to the credit of States.....	71,896,082.55

It certainly seems that any plan which would leave \$79,790,000 of debt yet resting on the States, out of a total of but \$207,894,000, can hardly be called an adequate measure of relief. But, on the other hand, when we notice the amount of Federal stock that must have been issued to grant adequate relief to the creditors of the local governments, the absurdity of assumption makes itself at once apparent. The only political theory with which it is in harmony is that the Federal government performs its proper function when acting as a financial collecting agent of States. If, however, the original purpose of the framers of the Constitution is to be maintained, which considers the sovereignty of the various grades of government as functional rather than territorial, the line which distinguished the finances of the Federal and the local governments must never be effaced. It was illogical for men who believed in maintaining the political integrity of the States to admit of any form of direct assistance from the central treasury. And in addition to this, it may be said that the issue of bonds to States that do not

¹ For detailed account, see the table in Johnson's "Report," pp. 120, 121. It will be observed that the total indebtedness here given is greater than that given on page 301; this amount includes certain "nominal debts" and "denied obligations."

need the money accruing therefrom, would be to invite in its most aggravated form the evils of surplus financing.

Still, there seem to have been some plausible reasons for the measure (as there undoubtedly were in favor of the first assumption), the most important being that the failure of the States to pay their debts would affect injuriously the credit of the Federal government.

I saw [says the author of the measure], or thought I saw, that the question would be, sooner or later, relief or repudiation. [And again:] Repudiation is avowed by but few at this time; but neglect to pay interest is the first silent step toward it. It now exists in confused contemplation in the minds of many, yet the moral sense of shame restrains the open avowal.¹

And in the report of the special committee the complaint is made, that the distrust caused by the remissness of the States had attached to the General government.

While nations without a tithe of our resources, and with large public debts, have been able to effect loans at 3 per cent per annum, the agent of this government had to return from the same market, where capital is seeking investment at 2 and 3 per cent, without receiving a single offer for any portion of a loan to our government at 6 per cent.²

There is no doubt as to the fact here stated. For a time the Federal government was put to some slight inconvenience, because the country from Maine to Florida was regarded "as one vast swindling shop" by our neighbors across the sea. But this was because the lines between State and Federal governments were not clearly defined, and because certain creditors of delinquent States in London hoped to force the assumption of local debts upon the central government by refusing to grant it financial standing.³ The em-

¹ "Report on the Relief of the States," p. 519.

² *Ibid.*, p. 5.

³ It is upon the authority of the late Mr. Raphael Bayley, whose "History of National Loans" forms such a valuable part of the late Census Report, that the following fact is given. The agent of the Federal government, upon presenting in England proposals of the Secretary of the Treasury for a loan, was met with the following reply from the house of Baring Brothers: "That, if the Fed-

barrassment, however, was of slight duration. The money which was desired was furnished by our own citizens, and within two years the stock thus created had risen to 14 per cent premium.

The proposal for assumption in 1842 appears in its most favorable light when regarded as a measure for refunding local obligations. The rate of interest was, on the average, 6 per cent. But could this rate be reduced to 3 per cent, a saving would be thereby effected of \$6,000,000; which, devoted to the establishment of a sinking-fund, would expunge the entire debt in eighteen years. These figures are a little fanciful, but they well illustrate the principle underlying the argument. There is no question but that the credit of the Federal government was better than that of the States, and, assuming the debts would be wholly paid, the country would have experienced a lightening of its burdens had the debts been guaranteed by Congress. The other arguments in favor of the measure may be passed without

eral government would assume the State debts, the firm would guarantee all the money it might desire at 3 per cent; but that if the States were left to control their own finances, the Federal government could secure no money in London at any price."

Further evidence of the fact is found in "*A Letter to a Lady in France, in Answer to Enquiries Concerning the Late Imputations of Dishonor upon the United States*," by Thomas G. Cary, printed in 1844. Speaking of this endeavor to secure subscriptions to a Federal loan, he says (p. 20): "The capitalists of Europe declined lending this; partly, perhaps, from real doubts of the solidity of our institutions, and partly, probably, with a view to make us all feel discredit so sensibly, that our national government should be induced to assume, as it has no right to do, the debts of the delinquent States."

There is considerable history, in connection with this question of assumption in 1842, that has yet to be written. It is always the case when accounts become involved that those who express an interest in clearing them up are charged with dishonest motives. Even Mr. Webster felt obliged to deny the imputation that he was retained by the Barings of London to use his influence in favor of the scheme of assumption.

But Mr. Johnson, who is the recognized sponsor for the plan, declares, with his characteristic modesty, that "the proposition originated with himself alone. . . . I neither borrowed the idea from any one, nor counseled with any one, nor was aided either directly or indirectly by any human being whatever."—"Report on the Relief of the States," p. 521.

mention. They are neither very logical nor pertinent, though the presentation of them requires a report of nearly six hundred pages. It is sufficient to say that Congress did not look with favor upon the scheme, and the matter was dropped. How far the agitation in favor of assumption may have influenced the States in deferring the levy of taxes for the support of their credit we have no means of determining with any degree of certainty ; but it is not probable that the history of local financing was much changed by the labors of Mr. Johnson's committee.

This chapter of financial history is not of so much importance in itself considered as in its influence upon the further development of our political and industrial constitutions. The financial disasters which we have described were followed by a reaction in public sentiment against State management of internal commerce, and, as is usually the case, this reaction showed strength proportional to the strength of the policy against which it was aroused. As the people had driven their representatives to enter upon internal improvements without caution, so, when taxes began to press, they censured them without justice, and disowned the policy. This reaction was complete and irresistible, and one may discover now, in the structure of industrial society, two facts that are traceable to it.

In the first place, the withdrawal of the States from the domain of internal improvements marks the rise of corporate power in the United States. As in 1830 the Federal government abandoned the thought of direct control over remunerative public works, giving up the field in favor of local governments, so, during the years from 1842 to 1846, a revulsion of sentiment turned all this business over to individuals. So far from realizing the programme of Jacksonian democracy, according to which the States were to recover their administrative importance, this experiment resulted in the establishment of a new power, unknown to the founders of our government, yet intrusted with truly sovereign functions. The rise of the corporation marks an epoch in the

history of inland commerce. The material advancement of the United States since 1850 no one can nor does one care to deny; yet the industrial, the political, and the social influences that have been introduced into national life by the unprecedented growth of corporate power, are the occasion for grave apprehension. Cities have been unnecessarily crowded; real estate values have been arbitrarily distributed; a social dependence is being introduced not surpassed in its evil tendencies by any previous form of servitude; politics are being run in the interests of profit to those already gorged with profit; while, from the political point of view, it is to the encroachment of private corporations, as much as to the centralizing tendencies of the Federal government, that the present impotency of the State governments is due. It thus appears that the financial crisis of the State treasuries was a turning-point in the development of national life.

In the second place, the failure of this policy of internal improvements led to radical changes in the constitutions of the various States. It requires but slight acquaintance with the detailed control of great enterprises to lead one to perceive that any stricture upon the power to borrow money curtails the ability of a government to manage canals or railroads. Previous to 1830, no State in the Union was in any way restricted in the employment of its credit; at the present time, however, there are but three States whose constitutions do not limit in some way the power to borrow money.¹ Michigan and Arkansas, admitted into the Union at the time that the fever for public improvements was at its height, incorporated into their constitutions a clause making it the duty of the legislatures to establish a system of public improvements. The sentiment that spoke in these cases through the general conventions of the people found expression in other States in current elections. But with the reaction of opinion, all this was changed. In 1848, and

¹ This subject again claims our attention in the last chapter of this treatise, where the details of the laws are portrayed.

the years following, the new constitutions, as well as amendments to the old ones, quite generally prohibited the States from having anything to do with remunerative works requiring capital. This finds direct expression in the organic laws of Wisconsin, Minnesota, and Michigan, while many constitutions, by curtailing the power to contract a debt, render it impossible for the States to incur those business obligations necessary for the economical prosecution of great works. It became the general cry that public works should be carried on by private enterprise, and to secure this, the States were prohibited from interference. The direct connection between these two theories of control is the best illustrated in the modification of the constitution of Illinois. Illinois had undertaken both State banking and State improvements, and had failed in both. In her new constitution of 1848, she retained the clause that internal improvements should be encouraged, but with this significant modification —this was to be done “by passing liberal laws of incorporation for that purpose.”

It is my intention to consider at length this policy of restricting the functions of local governments, when all the facts bearing on the case shall have been presented; for the present it is only necessary to hold clearly in mind the three steps by which our industrial constitution has attained its existing form, and a statement of these stages of growth will serve as a summary of the foregoing analysis.

The people of the United States of America began their national life as an aggregation of localities bound together by the tie of political interest. They had at first no trade and no internal commerce, and for this reason the industrial idea did not appear of much importance. The purpose of establishing a political sovereignty claimed the attention of early statesmen, and industrial interests were made in all respects subordinate to political considerations. In this relation of the two interests to each other—the political and the industrial—do we find the explanation of the fact that, while the States showed great jealousy of the Federal government in the extension

of its political powers, they were yet quite willing to concede to it the duty of developing inland commerce. In addition to this general suggestion, there are two significant facts which the period of history we are now considering portrays. First, the prevailing sentiment of the time did not deny to government agencies the right of assuming control over industrial enterprises. Second, the policy of internal improvements by the Federal government broke down under the stress of legal criticism, and not because the purpose of Congress failed to meet the approval of the public. The doctrine of *laissez faire*, so far as matters of internal organization were concerned, had not then many converts in this country.

The second step in the development of the industrial constitution was taken when the Federal government gave up to the States the duty of providing for internal commerce and for the issue of bank notes. The transfer of these duties was typical of the sentiment which then prevailed. As we have seen, this experiment by the States proved a failure, and, because of the financial disasters which followed, the entire business of internal improvements was passed over to the control of corporations. It is this transition which marks the beginning to the third period of industrial development in the United States, and it is at this point in the history of administration that the financial operations of the commonwealths cease to be of much importance, while that of the cities and minor civil divisions is forced into prominence. My own opinion is, that it was a mistake for the States to abdicate certain sovereign functions in favor of private corporations, for the evils thus incurred have proved greater than the evils escaped; but the soundness of such a conclusion can only be determined after a study of the financial development of the minor civil divisions.

CHAPTER III.

MUNICIPAL INDEBTEDNESS.

WE come now, in the course of our study, to consider the debts of cities and minor civil divisions. The general facts pertaining to this class of obligations in the United States have been already presented, and the development of local indebtedness to the time when municipal governments came to the front has been traced. It can not be said that any serious danger attended the use of local credit previous to 1865. In 1840, the debts of cities amounted to little more than \$25,000,000, and there appears to have been no flagrant abuse of authority on the part of those controlling municipal affairs. It is quite possible the disasters attending the endeavor of the States to carry on public works may have kept the inferior governments to a conservative fiscal policy. So late as the year 1860, the bonded indebtedness of the cities containing a population of 7,500 and upward was but \$51,000,000, and the total of local obligations resting upon the minor civil divisions could not have exceeded \$100,000,000.

But from this time on, the practice of municipal borrowing seems to have spread with great rapidity. By the year 1870, the combined debts of cities, towns, counties, and school districts amounted to \$515,800,000; and during the ten years that followed, \$306,300,000 were added to this sum. These figures, it should be noticed, represent the amount of outstanding obligations less sinking-fund accumulations. The total bonded debt of the inferior corporations was, in 1880, \$822,100,000.

It requires but a slight consideration of the centers from

which this grand total has sprung to perceive that the larger portion of existing local obligations is chargeable to the cities and large towns. The sum for which the counties are responsible is \$123,800,000, and this is less by \$64,000,000 than the amount due in 1870. The township debt in 1880 was \$31,600,000; the debt of the school districts was \$17,500,000; while that of the towns and cities with a population of less than 7,500 was \$55,800,000. From this it appears that the 311 large cities and towns in the United States are responsible for considerable more than half of all local debts.

Nor do the above figures adequately present the tendency toward the employment of credit that comes with increasing density of population; as between the cities themselves, greater looseness in fiscal methods may be observed as municipal numbers extend. The average per capita debt of all the cities in the United States is \$51.15. Twenty-one of these cities contain each a population of 100,000 and over, and of this number there are but five that fall below the average in their per capita indebtedness, while the obligations of many of them pass far beyond that of the average city. Thus the per capita debt of Jersey City is \$127.45; that of New York city is \$90.71; that of Pittsburgh is \$90.38; that of Providence is \$89.39; while Cincinnati, New Orleans, Philadelphia, and others, do not fall far below those already mentioned. From a careful analysis of local financing for the ten years following the year 1876 it is observed that the rate of increase of indebtedness in large cities stands to the rate of increase in small cities in the ratio of 187 to 98.¹ The twelve cities taken to represent the former class are New York, Philadelphia, Boston, Chicago, Cincinnati, St. Louis, Baltimore, San Francisco, New Orleans, Brooklyn, Louisville, and Pittsburg; while in the second class are included Allegheny, Columbus, Chelsea, Davenport, Fort Wayne, New Haven, Paterson, St. Paul, Taunton, Troy, Utica, and

¹ Cf. "Report of the Commission to Devise a Plan for the Government of the Cities of the State of Pennsylvania," pp. 96-108.

Burlington. The comparison of the fiscal condition of these two classes of municipalities is quite interesting:

Financial condition of twelve large cities.

Aggregate increase of debt in ten years	187 per cent.
Aggregate increase of valuation in ten years.....	74 " "
Aggregate increase of taxation in ten years.....	86 " "
Aggregate increase of population in ten years.....	88 " "
Amount of debt per capita of population.....	\$86.50.

Financial condition of twelve small cities.

Aggregate increase of debt in ten years	98 per cent.
Aggregate increase of valuation in ten years.....	121 " "
Aggregate increase of taxation in ten years.....	108 " "
Aggregate increase of population in ten years.....	42 " "
Amount of debt per capita of population.....	\$26.50.

One may not, however, properly conclude that the financial government of the small cities is above criticism, for not a few of them rival their more populous neighbors in the recklessness of their appeals to public credit. The State of Maine enjoys the unenviable distinction of containing four of the most heavily bonded cities in the Union. The average per capita indebtedness of all her cities is \$98.78. Bath, a little town of about 8,000 inhabitants, bears a per capita debt of \$216.69; the per capita debt of Bangor is \$157.87; that of Portland is \$127.84; that of Rockland is \$129.88. The condition of Elizabeth, New Jersey, is well known. With a population of 28,000, she owes more than \$5,000,000, which is a per capita charge of \$195. The consequence is that the value of her property has rapidly deteriorated, and that a city whose position presents many attractions for the establishment of a wharfage and loading business has ceased to grow.

It is also a significant fact that municipal debts have grown more rapidly than taxable property or population. According to the report of the Pennsylvania Commission, a carefully prepared table showing the increase of population, taxable valuation, taxation, and indebtedness of fifteen

of the principal cities of the United States, from 1860 to 1875, exhibits the following results:

Increase in population.....	70·5 per cent.
Increase in taxable valuation.....	156·9 " "
Increase in debt	270·9 " "
Increase in taxation.....	363·2 " "

Such facts as these might be multiplied without limit, but so frequently have they been brought to public notice that they are no longer regarded with surprise, although they may be read with solicitude. Nor will it aid my present purpose to dwell longer upon the recital of details. The main fact is sufficiently well recognized. The States have ceased to employ largely their public credit, and the cities and minor civil divisions have come forward as the chief borrowers of money. It is the aim of the present chapter to seek an explanation for this recent change in the balance of local indebtedness, and to correlate this tendency with other observed facts of national and social growth. It is essential that this tendency be well understood, for then only can its true character be determined. Is it open to full condemnation, or may it in part be commended? So far as it comes under just censure, wherein lies the responsibility for the evils which it entails, and what is the nature of the remedy that may arrest the further extension of so dangerous a tendency? Such are the questions that now claim our attention.

The financial administration of local affairs in England and France discloses the same tendencies respecting the use of credit as make their appearance in the United States. This fact is of considerable importance, for it leads us to expect that the causes responsible for this tendency are, in part at least, of a general rather than a local character. In France, for example, the departments were wholly free from debt until the rise of the second empire, and the communes were but moderately burdened; but with Napoleon III came lavish expenditure of borrowed money throughout the entire country. By the year 1869, the communes, exclusive of the city of Paris, were indebted to the sum of 524,000,000

francs; in 1872 these obligations had increased to 710,800,000, and in 1876 to 757,400,000.¹ The debt of Paris grew with significant rapidity upon the establishment of the imperial government, nor can it be said that the administration of the republic has in any degree checked the tendency. In 1865 the indebtedness of the capital city was but 60,000,000 francs; in 1872 it had increased to 1,130,000,000, and by 1880 had attained the enormous figure of 2,295,000,000.² The principal branch of municipal expenditure at the present time is chargeable to the account of interest and sinking-fund, demanding annually nearly 100,000,000 francs.³

In England the same tendency is to be observed in the administration of local affairs. The indebtedness of England and Wales, secured by local rates and dues, was in 1880 £137,000,000, being an increase of £73,600,000 in nine years. The local indebtedness of Scotland in 1881 was £16,300,000.⁴ The per capita debt of Birmingham is £14; of Manchester, £16; of Leeds, £12.⁵ The cities of Northern Italy have followed in the same path, while those of Germany, although less encumbered than in other countries, present many instances of growing indebtedness. In view of such facts, it is useless to suppose that local causes can adequately account for the rise of local debts.

Still, the following explanation of local indebtedness holds closely to facts as they present themselves in the United States, general causes being admitted only so far as they are clearly exemplified in the history of this country. And it may be well to state at the outset the conclusions that will be reached. As the matter lies in my own mind, local administration, during the last twenty-five years, has been largely shaped by three facts. These are as follows:

¹ "Etude sur la Gestion Financière en France depuis 1871," Noël, p. 76.

² Martin's "Year Book," 1884.

³ "The Condition of Nations," G. Fr. Kolb, pp. 219, 220.

⁴ "Ferm on the Funds," 1888, p. 39.

⁵ A. J. Wilson in "Nineteenth Century," N. S., vol. xxxv, p. 410.

1. The rapid growth of urban population has imposed new duties upon those who administer local affairs.
2. The refusal of the several States after 1845 to further assist in the opening of highways of commerce, forced the private corporations, into whose hands the business fell, to present their appeals for assistance to the minor civil divisions.
3. The imperfect development of administrative methods under democratic rule has invited corruption on the part of local officials.

In the somewhat extensive literature upon this subject, many other causes have been assigned for the facts under consideration, but it is believed that all, so far as they are pertinent to the case, may be referred to one of the three expressed above. These will claim our attention in the order in which they have been presented.

Local Debts as Influenced by Rapid Increase of Urban Population.

Many forces have contributed to introduce changes into the social and industrial life of the nineteenth century, but none have exerted a more marked influence than the development of steam transportation.¹ Distance has been annihilated so far as trade and commerce are concerned, and the choice of a spot where men shall build for themselves a home is largely independent of a country's topography. At the same time that new lands have been rendered available for agricultural purposes, new methods have been discovered for working them, and in this manner the productiveness of agricultural labor has continually increased. There is thus presented the possibility of a more rapid growth of urban than of rural population. The United States is properly said to be an agricultural country; yet during the last thirty-

¹ For an interesting presentation of this subject, compare "La Transformation des Moyens de Transport, et des Conséquences Économiques et Sociales," by Alfred de Foville. Also "Nationalökonomik des Handels und Gewerbeleisses," by Wilhelm Roscher, P. I, cha. x and following.

five years the city population has increased from twelve in the hundred to twenty-five in the hundred. The following table, taken from the census of 1880, shows the proportion of urban and rural population for each decade since 1790.

*Table showing the urban population of the United States,
1790-1880.*

DATE.	Population of the United States.	Number of cities.	Population of the cities.	Inhabitants of cities in each 100 of total population.
1790.....	8,929,214	6	181,472	3·3
1800.....	5,308,488	6	210,873	3·9
1810.....	7,239,881	11	356,920	4·9
1820.....	9,683,822	13	475,185	4·9
1830.....	12,866,020	26	864,509	6·7
1840.....	17,069,458	44	1,453,994	8·5
1850.....	28,191,876	85	2,897,586	12·5
1860.....	31,448,821	141	5,072,256	16·1
1870.....	38,558,371	226	8,071,875	20·9
1880.....	50,155,783	286	11,318,547	22·5

This movement, shown in the figures here presented, is not confined to the United States, but makes its appearance in all countries that have adopted modern methods of industry. Between the years 1833 and 1873, the nine chief cities of Europe doubled in the number of their inhabitants. Nor can this increase in city population be assigned to the excess of the birth-rate over the death-rate in the cities themselves. The towns grow because they feed upon the country.

An estimate, based upon returns from thirty-one of the largest cities of Europe, shows that of every thousand increase in urban population, two hundred and fifteen only spring from excess of death-rate over birth-rate. The census of 1880 shows the same tendency to exist in the United States. In very many parts of the country the little towns of eight or ten thousand inhabitants are drawing from the country surrounding them, so that in many localities the farming people are actually decreasing in numbers even in agricultural communities. This is the case, for example, in the southern tier of counties in the State of Michigan.

But of what significance is this movement of peoples from the country into the towns to the question of local indebtedness? There is, of course, no necessary relation between these two facts, although, under the influence of prevalent ideas respecting the funding system, and taken in connection with existing rules of municipal control, the one appears to follow naturally from the other. As cities grow in numbers and area, new duties are imposed upon their governments, and new sources of expenditure are constantly opened; and the temptation is great for cities to find immediate relief by drawing bills upon the future.

There are those who claim that the natural result of an increase in population is a decrease in the necessary burdens imposed upon those who pay the taxes, a view clearly presented in the following quotation :

Every increase in the population of a city, and enlarged area of assessment, should normally result in a decrease of debt per capita, and a decrease in taxation; because both the natural increase of the population and the increase in taxable valuation of properties would naturally create economies in all the services rendered to a great city which the municipal administration undertakes to supply.¹

If we accept this view of the case, it is right to conclude that the natural result of increasing numbers is a fall in the rate of taxation; but it is doubtful if such a claim can be maintained, for it rests upon the assumption that the growth of a city means merely the extension or duplication of what already exists. This, however, is far from correct. When a city or a town doubles its population, its original personality is largely lost. It has changed its character as a city, and is no longer confined to the wants it once felt, nor amenable to the rules that once controlled its councils. As localities come to be more and more densely settled, not only are new duties imposed upon their governments, but the performance of accustomed duties requires greater care and expenditure. The

¹ Cf. "Cyclopaedia of Political Science," article on "Administration of American Cities," by Simon Sterne.

extension of the police department, for example, must be proportionally more rapid than the growth of a city in numbers, for density of population breeds crime. The same is true of the health department. Disease springs from filth, and filth is the natural consequence of crowded quarters. Cleanliness can not be expected, where many people are packed together, unless made the care of the government; and the difficulty of keeping a city clean is increased as tenement-houses multiply. In a small town the demand for water may be cheaply met; but double the numbers, and a sufficient water-supply frequently becomes the occasion for great expense. It is the same with sewerage, streets, and pavements. Dirt roads and surface drainage do not answer for populous cities. New wants, also, are developed by growth. A country village, where land is cheap, and each house may be surrounded by its grass-plot, is in no need of a public park; but in a densely crowded city these breathing-places are essential for morals as well as health. There are, too, many forms of gratification which lie beyond the purse of a small community, but which may be enjoyed at slight expense to each citizen when large numbers combine in paying for them. Such are public libraries, the higher grade of education, public driving-parks and boulevards, city decorations, and the like. It seems, then, that the legitimate needs of a growing city extend at a more rapid rate than the growth itself. A developing society must of necessity make continually larger demands upon government, for the principle of common property under public management extends to new objects, and embraces new purposes, as a community grows in numbers or in riches. It is then hardly correct to say, as the author from whom we have quoted has said, that "the natural increase of the population . . . would naturally create economies" in the services rendered by the government. The natural result of an increase in population is to create new wants, and to demand an extension of the tax-levy.

But again, the conclusion that economy comes with an

increase of municipal numbers erroneously assumes that the principle of division of labor is of extensive application in the business of government. In many forms of manufacturing it is true that the larger the number of laborers employed the lower the cost of production. There is economy in union of action, and union of action is always possible when there is an assured market for the service rendered. But it is equally true that this economic principle is limited in its application. Not all forms of useful service can be rendered cheaper when rendered for a large constituency, and among the notable exceptions to this rule is the business of government in many of its branches. There is, therefore, no reason to conclude that the growth of a city will naturally lead to a decrease in the *per capita* expenditure, even though we leave out of the account the extending duties which growth imposes.

The question here brought to view is a very important one, and should be considered in all its phases. Following, then, a step further the opinion expressed by Mr. Sterne, we are led next to inquire if "the increase in the taxable valuation of properties naturally creates economies in the services rendered to a great city"? The facts pertaining to valuation of taxable property do offer some support to such a conclusion. It is in general true that the average wealth of citizens increases with the increase in municipal numbers, although it is very easy to overestimate the importance of this fact. It has been estimated that the *per capita* valuation of property in the larger cities increased 50 per cent from 1860 to 1875; but no reliance can be placed upon such a conclusion as indicating normal tendencies in values, because the period considered includes the years of civil war and paper currency. A similar estimate, including in its view the ten years following 1865, shows the increase in *per capita* valuation to be but 23 per cent, while for second-class cities the tendency seems to be in the opposite direction. It is, of course, impossible to lay down any rule by which the increasing needs of cities in general may be measured against

their increasing ability to pay cash for services rendered ; but there is much reason for believing that the legitimate demands of a growing city will outrun its ability to provide for them while maintaining the same rate of taxation. If this be accepted as correct, one can not say that an extension of the basis upon which taxes are computed will "create economics," although such influence as it exerts lies in that direction.

But, notwithstanding increased valuation, there are special reasons why growing demands invite an appeal to loans. The riches that come to a city with extension of numbers are unequally distributed. The average wealth of the community may increase, but the ability of the average man to pay taxes decreases. It follows, therefore, that an extension of the tax-levy, consequent upon an increase in numbers, calls for payments in continually larger amounts from those who are wealthy ; and it is this consciousness of increased burdens, taken in connection with the knowledge that municipal growth extends business and enhances the value of real estate, which inclines men of wealth so readily to acquiesce in an issue of bonds.

The mention of the words real estate suggests another reason why ambitious cities are so willing to incur heavy indebtedness. In new and rapidly developing communities, there is always an opportunity for men who have secured an interest in the soil of a particular locality to make large sums of money if only the tide of migration may be allured to come their way. The motives that lead men to select one spot as a home rather than another are frequently very slight, and sometimes without basis. A good pavement on the street, a fine school-house, a public park, an imposing court-house, or any public work that indicates what businessmen call "enterprise," will be apt to prove more persuasive than the boast of a "slow town" that her finances have been conservatively managed. Land agents must be furnished with fitting topics of eloquence ; and if Nature has bestowed her bounties with equal hand, so that one locality is very like

another, these subjects of discourse must be artificially provided. In this manner it comes about that the bonding of a town, and the expenditure of the money procured in showy works, is the occasion of actual gain to those who speculate in real estate; for the public burdens are in the beginning but slightly increased on account of the money borrowed, the money is expended so as to allure settlement, and this secures a market for real property at constantly enhanced prices.

The mischief of such a procedure would not be so great if confined to a single town, but there is no reason why neighboring localities may not adopt the same tactics with the same end in view. In such a case, it is known that success depends upon the comparative excellence of the showing, and there consequently springs up local rivalry in the building of public improvements and in lending public credit to private corporations. It is true that this policy may be carried so far as to defeat itself, for the settler is not blind to the fact that the bonds of a city are an incumbrance upon any property he may acquire within its limits. But whether successfully managed or not, it results in a great increase of unnecessary debt, and it can not be denied that many of our smaller cities and towns can trace the origin of their debt to the agitation of speculators in real estate. Indeed, we are fully prepared to accept the testimony of the Pennsylvania Commission of 1878, "that the undue accumulation of debt in most of the cities of the State of Pennsylvania has been the result of a desire for speculation on the part of owners of property themselves."¹ And in explanation of this it is added: "Large tracts of land outside the built-up portions of cities have been purchased, combinations made by men of wealth, and councils besieged, until they have been driven into making appropriations to open and improve streets and avenues largely in advance of the real necessities of the city. In many of these cases, owners of

¹ Cf. Report, p. 6.

property need more protection against themselves than against the non-property-holding class."

The unprecedented growth of urban population since 1860 is not urged as an apology for the funding system in local affairs, nor as a defense of those who have controlled municipal administration. But certainly the facts recited show how great is the temptation to issue municipal bonds. New demands constantly arise, and taxes rest upon those who have money with constantly increasing weight. Property meantime rises in value, and business of all sorts expands. Under such conditions it does not seem inexpedient to mortgage the future prosperity of a city. The readiness with which credits are voted is one of the natural results of that optimism always felt by members of a growing corporation.

Local Debts in their Relation to Development of Highways of Commerce.

In further explanation of local debts, it will be necessary to continue our study of the last chapter pertaining to public assistance of railroads and canals. As will be remembered, the course of financing there portrayed came to a disastrous close. The State treasuries failed to meet their obligations out of the income of such public works as had been established, and the people found themselves burdened with increased taxes to pay the accruing interest on "public improvement bonds." This occasioned a revulsion of feeling so intense that the organic laws of many of the States were radically modified, and the entire control of artificial highways of commerce was thrown into the hands of private corporations. While the lesson of this failure was fresh in the minds of the people, there appears to have been no demand that governments should employ their sovereign credit to collect capital for public works.

It was not long, however, before the public again appealed to governmental agencies for direct assistance in reclaiming new territory. The Federal government responded most

willingly, by making liberal appropriations of lands to railroad corporations, and the States, although prohibited by their organic laws from rendering direct assistance, yet discovered a way of granting material aid. The minor civil divisions were not included in the disabling acts of the new or amended constitutions. Being creatures of the legislatures, their powers were determined by the legislatures, and it was no difficult task to obtain for them authority to issue bonds in favor of private corporations. Such a method of procedure appears to me to have been wholly without defense, but upon that question we can not now enter. As a result of this policy, we find that in 1880 township and city bonds amounted to \$185,000,000, being a sum equal to one-sixth of the total of local indebtedness. Nor did this pernicious tendency stop with the issue of railroad bonds. Credit-financiering as a part of local administration became familiar to the people, and it was but a step to the conclusion that other enterprises more nearly of a private nature might rightfully receive the assistance of the local treasuries.

But it may be asked: What right has a legislature to authorize a township or a city to do that which by public law it is itself prohibited from doing? This is a question that has been raised in many of the States. When presented to the Supreme Court of Michigan it was held that the legislature possessed no such authority as it had assumed, and a law empowering towns to loan their credit for private purpose was declared unconstitutional. The Supreme Court of Iowa pronounced a similar decision, but this decision was afterward reversed. In many other States the same point was raised, but in all, with the exception of Michigan, the courts were subservient to the manifest wish of the people, and supported the laws granting to municipalities the power to issue railroad bonds. And there is, in truth, much to be

¹ Previous to 1880 Congress had granted 215,000,000 acres of land to railroads and canals, of which titles were secured to 150,000,000 acres.

said for such decisions, for, after all, the decision of a court is but the conservative expression of the popular will.

It is not, however, with a view of discussing the legal principle involved that this question was brought to our notice, but rather to show that the relation here traced between the restrictions imposed upon the States by their constitutions, and the issue of local bonds for granting assistance to railroads, exists in reality, and not in fancy. It is found in the legal thinking of the country, and makes its appearance in many of the cases brought before the courts which involve the validity of railroad bonds.¹ It is not, then, an accident that the expansion of local credit took place almost immediately after the States had been shoved off the stage of industrial action; indeed, one is warranted in the suggestion at least that, had the States been free from the legal restrictions imposed upon them by their constitutions, the inferior governments would never have been thus forced to respond to the popular clamor for a collection of capital by governmental agency.

Local Debts in their Relation to Questions of Local Government.

It is probable that the large majority of men regard corrupt practices in the administration of cities as the main source of local debts, and it is unfortunately true that corruption in politics is in large measure responsible for the evils of local financing. Perhaps no municipality has suffered more from falling into the hands of political Philistines than the city of New York. This city was mulcted of \$15,000,000 in a single year by a corrupt ring of officials, and it is estimated that one half of her present debt is due to extravagance and fraud. Other localities have suffered in the same manner, though possibly in a less degree. But an investigation into municipal indebtedness, which proceeds no further than to lay bare the fact of political corruption, can

¹ Cf. Bay City *vs.* State Treasurer, "Michigan Reports," 23, p. 504.

not hope to add any pertinent suggestion for the solution of the problem of local government. It is believed that the analysis which follows does take one step in advance of the views commonly held. Admitting official corruption to be directly responsible for much of the looseness in financial administration, it points to the fact that the present organization of cities, and the existing structure of society in which they are imbedded, invite to such corruption. This is an important fact if true, for it shows that the problem of local government is not an isolated problem, but rather a subordinate part of the great social problem now pressing so urgently for solution.

But, before undertaking to show the ground upon which such a claim rests, it may be well to notice some of the current proposals for introducing honesty into municipal affairs. And first, what can be said of the cry that politics must be purified? This is undoubtedly true. The purification of politics is a continuous task, like the cleansing of the streets of a great city, or the renewing of a right purpose within the human heart. The common meaning of this phrase is that "good men" should be elected to office, but the inadequacy of this as a practical measure will at once appear when one asks who these "good men" are whom it is proposed to intrust with public affairs. They are always men out of office, and most frequently men whose tastes do not incline them to undertake a public career. Indeed, as things now are, the fact that a man is desirous to secure an election is presumptive evidence that he is not the "good man" whom the people want. It seems, then, that purification of politics means that certain individuals should sacrifice their personal inclinations to the public good; while those to whom public duties are agreeable, and who for that reason might be expected to serve the public well, are on that account to be forced into the background. It is true that exigencies may arise when every citizen should be willing to make personal sacrifices for the public good; but there must be something wrong in a society whose normal welfare demands continual sacrifice,

for a truly organized society should pay just regard to the personal inclinations of its members. There is, in truth, nothing tangible about this phrase, purification of politics. It is largely cant, and is as frequently used by corrupt men as by men of honest purpose.

Perhaps the most popular remedy for corruption in municipal affairs is found in the claim that city suffrage should be placed on a property basis. This proposal presents itself in many forms, but the principle involved in them all, as also the reasoning upon which they all rest, is the same. Among the most conservative of these proposals is the one found in the report of a commission appointed by the Governor of the State of New York "to devise a plan for the government of cities." It was proposed by this commission that a "Board of Finance" should be elected in every city of the State. In cities containing over one hundred thousand inhabitants, this board was to be elected "by electors of the city (otherwise qualified under Article II of the Constitution) who shall, for two years next preceding the election, have paid an annual tax on property owned by them, and officially assessed for taxation in such city, of the assessed value of not less than five hundred dollars, or shall have actually paid during the same period a yearly rent for premises in said city, occupied by them for purposes of residence or lawful business, of not less than two hundred and fifty dollars." For cities containing a less number of inhabitants, the pecuniary requirements for the privilege of suffrage were somewhat modified, but the principle stated was applied to all. It was further provided that all initiative in matters pertaining to expenditure and taxation should rest with the "Board of Finance." Objections presented by the mayor could be disregarded, and it was specifically stated that "no power vested in the Board of Finance shall be conferred on or exercised by the Board of Aldermen."

It requires neither extended reading in history nor a penetrating knowledge of practical affairs to perceive what

this proposal means. The man who holds the purse-strings wields the scepter. And since this board is created by votes representing property, the result of granting it authority would be to establish city government on a property basis. Such a proposal demands careful scrutiny before it can meet with hearty approval.

Admitting for the moment the principle involved, it is, under present conditions, impossible to restrict suffrage to property owners. The people in the United States regard manhood suffrage as the bulwark of personal liberty; and, looking into past history, which after all is the source of popular prejudice, whether among the learned or the ignorant, they have reason for such a belief. But this plan of the New York commission proposes a curtailment of suffrage, a measure which can only be carried through by the exercise of suffrage. The question then resolves itself to this: Will men vote to deprive themselves of the right to vote? The only chance of securing such a reform lies in the fact that laws governing cities emanate from the State legislature, and that this body may for a time be dominated by those who live in the country. But who, knowing the jealousies that exist between country and town, can hope for a permanent law restricting in any degree the political rights of citizens in municipalities? For it must be remembered that the men whose privileges are thus curtailed in the cities would still be voters in all State elections, and, this being the case, we may be sure that the question of municipal suffrage would not quickly disappear from State politics. The plan is altogether impracticable. The only path to restricted suffrage in this country lies through two revolutions: the one resulting in the establishment of a Dictatorship, the other in the re-establishment of a Republic in which votes shall represent wealth. They who are not willing to adopt drastic remedies of this sort, but who yet advocate that property owners in cities should control all finance bills, err in the same manner as a physician who prescribes medicine so strong that the stomach of his patient can not retain it.

But can we admit the principle involved? The line of reasoning which favors the proposal to restrict municipal suffrage to property owners is, upon its face, quite plausible. It starts from the assumption that the duties imposed upon a city government are either political in their nature, or pertain to the co-operative management of private property. So far as these municipal duties are political, it is admitted that all citizens should be granted a voice in their control; but so far as they pertain to property, it is thought to be an impertinence on the part of men without property to interfere. This argument is nowhere better formulated than in the interesting article by Mr. Simon Sterne already referred to. The author supports his case with intellectual vigor and many references to history.

Two mistaken roads [says Mr. Sterne] seem to have been followed in all legislation in this country as to cities, and which have resulted in disaster. Insufficient analysis has prevented our people from seeing that a city is at one and the same time a decentralized portion of the general government of the State, and a co-operative organization of property owners for the administration of private property. The mayor, when he enforces an ordinance for the preservation of the public health . . . is a public State officer deriving his authority from the suffrages of the citizens in whose midst he holds sway. The mayor, when he signs an ordinance for the grading and regulating of a street between certain avenues, . . . is a mere instrument to make and enforce a contract between property owners. [The people who own the property through which streets are to be cut can not come to an agreement,] and therefore the law makes contracts through the instrumentality of the mayor for them.¹

The author then proceeds to analyze the various duties commonly imposed on public officials, and to label one set public and the other set private. Street lighting, for example, is undertaken by the local government in its capacity as the representative of property owners; the police power, on the other hand, is regarded as a power distinctively gov-

¹ "Cyclopaedia of Political Science," Article, "Administration of American Cities."

ernmental in character. In support of such a distinction, the author refers to the fact that in olden times rich people used to hang lanterns out on the corners of their houses, and hire linkboys to carry torches before them on dark nights. This appeal to history, however, is unfortunate. The truth with regard to public lighting is that this service was brought under the control of municipal government in order the more perfectly to administer the police duties. It is because a lighted city prevents crime, and not because it is disagreeable for one with polished boots to step in the mud, that public lighting is supported from the proceeds of taxes.

We can not, however, trace the course of this argument in detail. Though it presents several inconsistencies, and though it makes irrelevant and inaccurate appeals to history, the chief criticism that lies against it consists in the erroneous conception of government upon which it is built. All clear thinking on matters pertaining to government must begin by recognizing that the state is the repository of the coercive principle of society, and that this constitutes its only essential and permanent characteristic. It is necessary that force should be employed for the performance of any duty calling for the general consent of large numbers of men, and wherever one may trace the exercise of force, according to established law or custom, there he discovers state agency. It is unnecessary to prove this, for it is the fundamental conception upon which all civil jurisprudence rests, and finds expression in the writings of all publicists who manifest a just appreciation of personal rights. Holding, then, this conception firmly in mind, is it not illogical to say that a "co-operative organization of property owners" can ever rise to the dignity of a city government? The rights and duties in a co-operative organization rest upon contract between the several members, whereas the rights and duties of a city come from a sovereign state and find expression in a charter. It is inaccurate to say that a mayor can, under any circumstances, become "a mere instrument to make and enforce a

contract between property owners." Such a statement contradicts the legal conception of a contract, which demands that all obligations which it records should be willingly assumed. Evidence of undue influence will defeat a contract; and certainly compliance with the wishes of a majority under threat of legal penalty can not be cited as holding even the remotest analogy to a contract. The truth of the case presented in the argument from which we have quoted is, that the mayor administered a law for the taxing of property owners, which law was enacted by the legislative body of the city, which body was authorized to legislate by the established powers of the State, which State derived its powers to grant such authority from the sovereign people. This act of the mayor, therefore, as every act of a public official, is rooted in the source of all public authority, the assent of the people. Nineteen property owners can not unite and coerce a twentieth property owner, but they can secure in their favor the exercise of the coercive power of government, by the adoption of well-known legal methods. The truth is, that a city constitutes an organic part of the general state, and can not be torn from the framework in which it is imbedded, nor is it possible to separate the duties assigned to it into governmental and private, since they are all governmental, resting as they all do upon the sovereign power of coercion. To hold the contrary view involves one in the error of endeavoring to define a state according to the functions performed, an endeavor which both history and analysis declare to be impossible.

I can not think this argument, resting upon the assumption that a city is an association of property owners, presents the considerations in favor of restricted suffrage in their strongest light. It is weak because built upon an erroneous premise, and in this country it must be ineffective because addressed to the prejudices of a class. The more candid, as well as the more consistent argument, proceeds from an analysis of the nature of all rights and privileges expressed in law. Such rights, whether political or proprietary, are

grants from society to individuals, made because it is believed the highest good of society and of individuals will be thereby promoted. This is the industrial defense of private property as against communal or national property, and it is the only logical ground for restricting control over public affairs. Could it be shown that, in the long run, there is greater likelihood that virtue, and honesty, and a proper care for the moral claims and general interests of all sorts and conditions of men, would reside with the property-holding class than with society itself, a clear and conclusive argument might be presented in favor of restricted suffrage. But neither history nor reason permits one to believe in the beneficent workings of class legislation. Democracy is not maintained because it is an ideally perfect form of government, but because the chances are in favor of the exercise of wisdom and justice if all men are secured the privilege of expressing their opinions. The evils that grow up in society will more quickly come to a head, and the process of healing will be more quickly accomplished. Could it then be admitted that the immediate effect of restricted suffrage would restore honesty to the management of city treasuries, the argument even then would not be conclusive, for the ultimate consequences of such a measure must also be taken into the account.

But can it be admitted that the immediate effects of property representation would elevate the moral tone of city politics? The reply of the Pennsylvania commission, to which we have made reference, is pertinent to this question, for it shows that any limitation of political privileges, by which the control of city affairs would be thrown into the hands of responsible property holders, must proceed so far as to exclude many honest and responsible members of society.

The provision recommended by the New York commission [says this report], requiring the payment of an annual rental of \$250 as a qualification for voting, would, in our State, exclude [a] very large and reputable class of citizens, while it

would not exclude the tenants of low grog-shops and other disreputable establishments, who, in most cases, pay a higher rent. While it would, no doubt, exclude some of the irresponsible class, it would also exclude very many of the sons of reputable property holders, who would exercise the right of franchise honestly and intelligently.

An additional argument of a practical nature is urged against the plan of restricted municipal suffrage by the Pennsylvania commission. Some share of the debts is charged to the interference of the Assembly in local affairs.

Again, it is but fair to say [says this report] that in many cases the largest debts have been contracted, not by the authority of councils, or any department of the city government proper, but under the provisions of special acts of the Assembly, appointing commissioners to open streets, park commissioners, building commissions, bridge commissions, etc., passed not only without the request of councils, but very often against their earnest protest. For these, and many other reasons which might be given, the commission are not prepared to recommend a property or rental qualification for voting as an adequate protection against municipal debt.

I do not expect that what has been said will be accepted as conclusive against the proposal of restricted suffrage. With regard to the impossibility of curtailing suffrage, it will be replied that this end may be attained by means of successive political combinations. The Irish may be worked against the negroes; the Germans may be combined against the Irish; the Americans can unite and oust the Germans; and then the "respectable property owners," will have it all their own way. This does not seem to me to be as practical a proposal as the one which relies upon the fact that State legislatures are usually dominated by the sentiments of country members. What I have said upon this subject is readily recognized as suggestive rather than conclusive. The question touches one of the fundamental problems in political philosophy. But it is hoped that enough has been said to raise at least a suspicion in the minds of my readers that the remedy proposed is inadequate because it is based upon a

superficial analysis of social relations. I shall undertake in the following chapter to trace the evil complained of to its true source, and to make good the claim with which this discussion began, that municipal corruption is largely due to the imperfect development of administrative methods under democratic rule.

CHAPTER IV.

POLICY OF RESTRICTING GOVERNMENTAL DUTIES.

It is frequently easier to criticise a proposed treatment of an evil than to suggest one more fitting to the necessities of the case, and in speaking further of that portion of municipal indebtedness which springs from corrupt practices, I am especially sensible of the embarrassment thus occasioned. Not only is the subject itself full of difficulties, but my investigations have led me to entertain views respecting it not in complete harmony with the prevailing opinions of the day. This, however, can not be urged as a reason for withholding an expression of such views as are entertained.

True Source of Municipal Corruption.

The first step toward understanding this subject is to recognize that municipal corruption is merely a symptom of deep-seated disorder in the body politic, and not a distinct and independent evil. Whatever the restrictions placed upon the power to borrow money, or whatever the established rules of suffrage, the record of municipal affairs during the past twenty-five years would, in all probability, have presented many instances of corrupt administration. We can not rest satisfied with a superficial analysis of this important subject. My own opinion may be stated in a sentence. The final explanation of municipal corruption is found in the fact that the present organization of society does not properly correlate public and private activity. The mistake which the people of the United States have been

making since 1840, lies in supposing that the business of government may be honestly carried on while strict justice and common honesty are not demanded by prevalent business sentiment; and that efficiency may be secured in public affairs while the offer of greater inducements draws efficient men toward private walks of life. Assuming this to be true, it follows that the problem of municipal reform is but a minor part of the problem of social organization, and that the true principle of reform consists in a redistribution of motives that induce personal conduct. Let us look into this matter a little more closely.

The life of all men is embraced in what we call society. This society is organic in its development, and confines within itself all individual growth and action. The activity which it displays is either public or private—that is to say, the activity of the state, embracing all governmental functions, and that of persons or corporations undertaken for private ends. But a government does not differ from a private corporation in the nature of the functions which may be imposed upon it; the essential difference lies in the fact that the services which it renders and the duties which it performs rest upon the direct exercise of coercive power. The line separating public from private duties is clearly defined so far as the principles are concerned to which each must conform, but it is ever changing for particular services. Each department of social activity exerts a decided influence upon the other, and failure to attain the best results in the one must affect injuriously the actions of the other. The important question, therefore, is: Under what adjustment may the best results be expected from both lines of activity?

The relation here suggested will be more clearly apprehended if we notice the difference between the principles which control a public and a private business. A private business is managed to secure profit; and, other things being equal, the higher the price obtained for any service rendered, the higher will be the profit secured. The rule of private

financiering is to maintain the price of goods or services at the highest figure which has no tendency to curtail profitable business. But the rule of public financiering conforms to an altogether different principle. It is the aim of government to render its services at the lowest possible cost consistent with efficient service. Price equals cost. This must be the case, for a state has no motive in acquiring riches. The officers of the state are in receipt of salaries, which, speaking roughly, may be said to correspond to the profit secured by the managers of private business.

But, although the rules involved in the two methods of doing business are thus opposed to each other, the one demanding the highest and the other the lowest price possible, it is generally assumed that, in the conditions in which they are respectively applied, they will effect parallel results; and the object to be held in view, in the formation of both the political and the industrial constitution, is so to arrange the social order that these results will be parallel. The functions of government are usually carried on as a strict monopoly, and the machinery of audits and public accounts is found necessary to insure fairness between the public official and the subjects whom he serves. Any deviation from fairness, in taking more for his service than his salary, is called corruption. In private economy, on the other hand, a legally established monopoly is contrary to every conception of right and justice. For why should the law give to individuals full control over any business when those individuals are irresponsible to the law for the manner in which they conduct it? The only guarantee for fair treatment, when men are striving to secure the highest price possible for services which they render, lies in the fact that freedom of competition among producers tends to bring the price of sale down to the cost of production.

Perceiving, then, the difference that exists between public and private control of business affairs, we may proceed to inquire under what conditions the best results may be expected from both methods of organization. The reply to

this question has been already suggested. The best results may be expected when the duties assigned to public officials and the functions performed by private individuals are so correlated that the inducements offered are of about equal strength in both domains of activity. It is of course necessary, in applying this rule, to take into consideration other than merely pecuniary motives by which men are led to act. Considerations of social distinction, the desire to exercise such powers as one may possess, the pleasure of filling well a responsible position, indeed, all the varied demands of human nature, must be admitted into the account. If the importance of the state is so emphasized, and the allurements in the form of social position or emoluments of office are so strong, that the best talent of the people is drawn into the public service, a powerful and efficient government will probably be established, but a very poor society. It is believed that Prussia is now suffering from the dearth of talent and vigor in common business enterprises, and that she must continue to suffer in this manner until the state relaxes its hold upon the brilliant and talented of her youth. A German sewing-machine is but a bungling affair, made after the abandoned models of American patterns; but German cities are, as a rule, well governed.

In our own country, on the other hand, one observes that society has developed in the opposite direction. Here the great prizes are in the line of individual initiative. Our civil service is so poor that an officer has no social position, while a business man who accumulates money is regarded with deference. The salary paid by the state is nothing when compared with what men of ordinary talent may secure either as profit if engaged in business on their own account, or as wages of superintendence if working for a private employer. It is, therefore, no occasion for surprise to learn that in this country we have very perfect sewing-machines but poorly administered cities.

It may seem that this explanation of municipal corruption lacks in the definiteness of its suggestions. It can not be

placed as a single plank in a party platform, nor be urged in a single bill before a legislative body. It is, however, pertinent, and should be permitted to exert a marked influence upon the decisions of those who frame our general laws. It does not regard the question of municipal corruption as an isolated question, but as a phase of the great social question now claiming so large a share of public attention. It holds that the true line of reform lies in such a modification of the relative strength of motives offered that men of ability and honesty will be willing and desirous to take upon themselves public responsibilities, for it believes that this must result in changing somewhat the spirit that now controls society.

One can not fully appreciate this view of the case without calling to mind the possibilities of acquiring wealth in a rapidly developing industrial society. The atmosphere of such a society is intensely commercial, and not only do men of ability and energy refuse to consider a public position as desirable for themselves, but they regard with supercilious condescension one who is willing to assume public office. And it may be added in this connection, as bearing on the question of municipal corruption, that the moral judgments of a public officer are very much like those of his neighbors who elect him, and the sentiments that control in the transaction of their daily business will probably give color to his administration. But the ordinary business life of the nineteenth century is such as to render men familiar with the methods of speculation, and to conform their ethical principles to the requirements of the law of supply and demand. The spirit of speculation partakes in character of the spirit of gambling. It judges of all business undertakings on the basis of their pecuniary success, and has little care for the equivalents given for what is gained. A fine sense of what is just can not exist where it prevails, nor can a delicate appreciation as to what is honest be long retained by business men who conform to its demands.

Suppose, now, a man of good intentions to come into public office in a community breathing the atmosphere of

commercial speculation, what does he see upon looking into the society whose welfare is placed under his guardianship? He sees it to be no uncommon thing, where freedom of contract is unrestricted, and where the principle of individual ownership is indiscriminately applied to all of the agencies of production, that fortunes are established in the hands of men and families having no moral right to them. Men who have been lucky in owning real estate that other men want; men whose mines happen to yield purer copper than other mines worked; men with timber-lands, salt-wells, and other gratuitous products of nature that come into demand as population increases—all increase their pecuniary importance out of proportion to their effectiveness as producers of wealth. He sees, also, that many businesses, which from their very nature must be carried on as monopolies, are given over to private control, to which the principle of private financing is applied with all its vigor, and thus large fortunes are accumulated, and large power over men acquired, exceeding by far the importance of any individual to society. He sees also that, in many businesses which are naturally subject to the regulating influences of competition, artificial combinations are established by means of which monopoly prices are secured from consumers. But such privileges as these can not pass unchallenged, and it naturally follows that the important lawyers of every town are retained at large salaries to defend by their tempered talents the privileges that monopolists have acquired, while other lawyers are hired to depart from their legitimate business, to secure for business men some special legislation. Yet all this is within the law. It can not be branded as corrupt, although the least sum taken by an official beyond his authorized salary is properly characterized as robbery.

As contrasted with this state of affairs, what does our candidate see in the office to which he has been elected? He will not long remain an incumbent before discovering that the position which he sought as a dignity brings with it no honor. What he thought to be a place of responsibility and

power, proves to be the center of no great influence, demanding in reality little beyond the perfunctory duties of a ministerial officer. He finds that there is small demand for the exercise of judgment, and narrow play for the development of manly faculties. He also learns, through the sinister suggestions of those whose personal interests he does not forward, that his tenure of office is insecure; and, last of all, he finds that his salary does not suffice to keep his family in a respectable condition, and that the gratitude of republics does not extend to provision for their servants against sickness and old age. Repeating again the assumption that our candidate is honest, at least within the meaning of the law, and that he is conscious of power, we are warranted in concluding that the career of an official will not harmonize with his tastes. He will upon the first opportunity return to private life, which presents larger scope for efficient activity, and where the prizes to be gained are much greater.

Such are the conditions of public life in most of the municipalities of the United States, and what may be observed as the result is altogether what might have been expected. The incumbents of local office are usually men of indifferent ability, and, if not of actually depraved, are at least of a colorless character. Among "city fathers" of this sort there appears from time to time the shrewd yet unscrupulous man who, for personal aggrandizement, assumes complete control of public affairs. This is the explanation of "rings" and "jobs," and this is the reason why public plunder by means of bonds, which has been the favorite method for the last twenty-five years, is but an accident in the development of corrupt practices. Corruption was suggested by the spirit of speculation that permeates all business methods, and invited by the weakness of municipal control. Following the line of least resistance, this spirit of dishonesty which pervades commercial communities made its appearance in the form of dishonest issues of bonds.

To proceed further in the discussion of municipal reform would be to go beyond the proper sphere of this essay; still

it may not be inappropriate to suggest one or two measures from which satisfactory results may be expected. It seems essential, in the first place, that civil service rules of the strictest sort should be applied to all cities and towns. For all duties of a perfunctory sort, a tenure of office during satisfactory service, and a suitable pension at the close of a definite period of service, should be established. Only under such conditions can a career be opened for men who undertake public duties; and until a satisfactory career is provided none but shiftless men will present themselves for local office. All that has been said respecting civil service regulations for the Federal government and for the States, may be repeated with emphasis when applied to cities. I am speaking here of county sheriffs and city treasurers, not of State governors or United States senators.

It seems also necessary that the element of personal responsibility be introduced into the administration of municipal affairs. No government can reasonably expect to be well carried on that divides the duties intrusted to it among a number of independent boards. The office of mayor, for example, is an office that demands independence and force of character in the incumbent, and for this reason we are led to approve the changes that have recently been made with respect to the government of the cities of Brooklyn and New York.

When to these suggestions it is added that the functions of a city government should be extended so as to include the rendering of direct services, as the supply of water, light, market facilities, dockage and the like, it is probable that many will withhold their consent, resting their opinions upon known instances of corruption and inefficiency that have followed such endeavors. But without calling attention to the many instances of successful administration of productive property by city governments, it may be said that the suggestions here urged follow necessarily from the foregoing explanation of the cause of present municipal corruption. The discussion, therefore, upon this point must revert

to that explanation. The common objection to this entire view of the case is that, after all, the true reason why men of ability and honesty do not care for public office lies in the fact that the constituency which they must serve is degraded and fickle. There is indeed much truth in this statement, but so far as true it strengthens the position which this essay assumes; for it shows in a yet clearer manner the fact, already brought to light, that the question of municipal corruption is but a phase of the general social question of the day. The peculiar form of political corruption which we have described is the flower and fruitage of our own generation, it is the natural result of endeavoring to manage a society according to the dogma of *laissez-faire*. This state of affairs, which is the growth of years, can not be changed at once, but the evils complained of will certainly remain so long as we presume to think that the best thing to be done with a public officer is to lay him on a shelf out of the way of doing harm. There is a beneficent principle in monopoly which can only be realized through the agency of the state. The path of reform lies toward a proper correlation of public and private duties.

Policy of Restricting Governmental Duties.

The foregoing conclusion rests upon a principle of wide acceptance in matters of internal administration, and we are naturally led, in the next place, to consider those restrictions imposed by public law upon the power of the States, or of the cities and minor civil divisions, to borrow money.

It is true that a complete investigation of this subject lies more properly in the domain of administrative law; but since the science of finance is closely allied to the science of law, it may be well to introduce the question at this time, so far, at least, as is necessary to complete the historical presentation of the development of financial powers in the United States.

The distribution of financial powers in any country must of necessity conform to the rule by which duties are assigned

to public or to private corporations. At the time the Federal government was established there was no controversy between those who urged a wide extension of public functions and those who advocated what has since come to be known as "the restrictive policy." There was no occasion for such a controversy; for, under the *régime* of hand industry, and while all enterprises were necessarily local in their character, because of inadequate means of transportation, there was nothing to suggest the necessity of governmental initiative in business affairs. Public attention was then drawn to questions of political rights, and to the proper distribution of political powers between the various grades of government established.

Not many years had passed, however, before another set of political ideas pressed for recognition. The introduction of textile machinery by the Eastern and Middle States led to the necessity of widened markets; and this, in a country situated like the United States, could mean nothing else than the establishment of facilities for interstate commerce. The first important steps toward this end were taken about 1818, and by 1830 the enthusiasm for public works had become general. But even as late as this it was the political question about which all discussion centered, for as yet the lines between public and private initiative had not been strictly drawn. How this line came to be established, and how the disasters that attended the experiment of State control over public works led the people to declare that their governments should have nothing further to do with highways of commerce, has been portrayed in a previous chapter. The occasion of the restrictions placed upon the minor civil divisions, analogous in all respects to that of the States, has been likewise disclosed. They too, after having run a reckless course of expenditure in favor of railroads and local improvements, have been placed under a similar restrictive ban.

It seems then that the general trend of the industrial policy of this country since 1840, as reflected in the laws of the various commonwealths, is quite in harmony with the teach-

ing of *laissez-faire*. The functions of government have been decidedly curtailed, while the powers of corporations under private control have been extended in a corresponding degree. There is no doubt as to the right of the people to disable their officials in any manner they may see fit; it is, however, an open question if, in the present instance, they have wisely exercised that right. Some steps looking toward restrictive legislation for private corporations have been taken since 1870, but this fact can not modify our general conclusion.

But, before discussing the propriety of such restrictions, it will be well to notice more in detail the nature of those financial and industrial limitations imposed upon local governments. These are found in the constitutions of the various States, in the charters of the cities, and in general laws pertaining to the inferior governments. It is the purpose of these limitations to guard the people against the evils of public indebtedness, and this they undertake to do, either by limiting the amount of debt that may be incurred, or by excluding the legislative body from those lines of enterprise which demand large sums of money. Many States have resorted to both of these methods. Confining, for the present, our attention to the States, as distinct from the minor civil divisions, a review of the various constitutions discloses the following facts.

A. Those States that place no financial or industrial restriction upon their legislators are New Hampshire, Vermont, Massachusetts, Connecticut, and Delaware. By the constitution of 1868, the legislature of Arkansas was prohibited from borrowing except for "casual deficits"; but by the constitution of 1874, "treasury warrants and scrip bearing interest" are alone prohibited, from which it seems that there is no restriction placed upon the issue of bonds.

B. It is the general rule among the States to place no limitation upon the power of contracting debts for purposes of public defense, nor are such restrictions as exist to be interpreted as imposing any obstacle to refunding operations.

Most of the constitutions, also, recognize the impossibility of adjusting at all times the expenditures of each fiscal year to the income of the same year, and consequently provide for temporary debts to cover deficiencies; but the amounts that may be borrowed in such cases are explicitly stated. The stipulations of public law upon this point may be seen from the following presentation.

Temporary debts may be contracted as follows:

New York,	not to exceed	\$1,000,000.	Art. VII, sec. 10.
Pennsylvania,	"	1,000,000.	Art. IX, sec. 4.
Kansas,	"	1,000,000.	Art. IX, sec. 5.
Ohio,	"	750,000.	Art. VIII, sec. 1.
Kentucky,	"	500,000.	Art. II, sec. 35.
California,	"	300,000.	Art. XVI, sec. 1.
Maine,	"	300,000.	Art VI, Amendment 1848.
Nevada,	"	300,000.	Art. IX, sec. 3.
Missouri,	"	250,000. ¹	Art. IV, sec. 44.
Illinois,	"	250,000.	Art. IV, sec. 18.
Minnesota,	"	250,000.	Art. IX, sec. 5.
Iowa,	"	250,000.	Art. VII, sec. 2.
Texas,	"	200,000.	Art. III, sec. 49.
Georgia,	"	200,000.	Art. VII, sec. 3.
Alabama,	"	100,000.	Art. X, sec. 3.
New Jersey,	"	100,000.	Art. IV, sec. 6.
Wisconsin,	"	100,000.	Art. VIII, sec. 6.
Nebraska,	"	100,000.	Art. XIII, sec. 1.
Maryland,	"	50,000.	Art. III, sec. 34.
Rhode Island,	"	50,000.	Art. IV, sec. 18.
Michigan,	"	50,000.	Art. XIV, sec. 8.
Oregon,	"	50,000.	Art. XI, sec. 7.

The debt of Colorado is not to exceed one-fourth of a mill "on each dollar of valuation of taxable property within the State," in any one year, and the total debt so created can not exceed three-fourths of a mill on taxable valuation. (Art. XI, sec. 3.)

Indiana, Virginia, and West Virginia limit the power of borrowing money to "casual deficits." (Compare for these

¹ This is the limit of debt that may be contracted in one year; it is further provided that the debt must be paid within two years.

States respectively, Art. X, sec. 5; Art. X, sec. 7; and Art. X, sec. 4.)

Louisiana places the limit of her debt at the lowest point below \$25,000,000 which shall be reached in the reduction of her obligations, until the debt shall be diminished to \$15,000,000. (Amendment, 1874, sec. 2.)

C. In some cases the limit of indebtedness, as above stated, does not mean an absolute limit, but that the States guard the exercise of the borrowing power, above the sums specified, by some legally prescribed method of procedure. This is the case in New York, Illinois, Iowa, Kansas, New Jersey, Rhode Island, Colorado, and some other States. The usual method is to require that the law authorizing such loans shall be submitted to the people for their assent. In Arkansas, a two-thirds vote is required to legalize such a bill. In some instances, as for example South Carolina (Art. 9, sec. 7), the passage of such a bill through the legislature is placed under rules of procedure more than ordinarily strict.

D. There are also exceptional limitations. North Carolina can contract no debt while existing debts are below par, unless the bill creating the debt contain a clause providing for an adequate tax. Wisconsin, Michigan, Minnesota, and Kansas are prohibited from contracting any debt for internal improvements. In Florida there are specific grants for contracting debts, but by the principle of exclusive interpretation the power to borrow money is limited to these grants. (Art. XIII, sec. 7.)

We can not speak with such definiteness of the restrictions placed upon the minor civil divisions. So far as the organic laws of the States are concerned, it does not appear that the people exercise that jealous care over the credit of municipal corporations which they show for the credit of States themselves. In some cases, as for example in the State of Ohio, the constitution imposes the duty upon the legislature to control the exercise of the taxing and borrowing powers "so as to prevent the abuse of such powers." Similar duties are imposed by the constitutions of Nevada

and Michigan. But provisions of this sort are mere registers of public opinion. They insure no action on the part of the legislatures, for they provide no method of legal compulsion. It lies in the nature of the relation existing between the States and minor civil divisions that the powers of the latter should be controlled. They are the creatures of State law, and, in the absence of express stipulations to the contrary, their exercise of public duties must conform to whatever conditions are imposed by law. It seems, then, that such a constitutional provision as that adopted by the people of Ohio grants no new power to the legislative body, nor does it necessarily act as a restriction upon the expansion of local credit. So far as the minor civil divisions are limited in the use of their credit by the right of control inherent in the State, the limitation is universal. Its mention in a constitution shows only that the people regard the exercise of this power by the legislature to be important.

But it is possible for the organic laws of the States to place effective restrictions upon the power of municipal corporations to contract debts, and that in two ways: First, the power to tax for the support of the interest of the debt may be limited to a definite percentage of assessed property. This method is employed in Alabama, Texas, Arkansas, Missouri, and Colorado. In some of these States the limit of taxation is a fixed limit, in others it varies with the amount of assessed property, decreasing as the wealth of the counties or cities increases. In the second place, the debts themselves may be limited to a specific sum or to a certain percentage of assessed property. The States employing this principle are West Virginia, Illinois, Wisconsin, and Minnesota, in which States the limit is placed at 5 per cent of assessed property. Pennsylvania restricts local credit to 7 per cent of assessed property, but for debts beyond 2 per cent a popular vote is required to legalize the bill. Indiana limits to 2 per cent except on petition of a majority of the property owners "in number and value." Colorado adopts the

same principle, and Oregon prohibits a county debt beyond \$5,000.

Other States rely upon an altogether different principle for the control of local financing. Without limiting the amount of debt that may be created, it is provided that some special safeguards shall be thrown about the passing of laws or ordinances affecting public credit. In North Carolina a majority of qualified voters must assent to bills creating debt; in Tennessee a three-fourths vote is required, and in California a two-thirds vote for all but deficiency bills. These statements, while far from presenting the subject in its completeness, are sufficient to show upon what principles reliance is placed for maintaining the debts of the minor civil divisions at a reasonable figure.

Perhaps the most effective method of providing against the evils of public indebtedness, when considered in connection with the history of railroad development in this country, is found in the almost universal provision against lending either State or local credit to private corporations. For presenting the facts of existing law upon this point, we may avail ourselves of the admirable table contained in the tenth census report.

Notes to Table.

- * Refers to towns only. ^b Unless expressly assented to by the people.
- * Counties only. ^c Unless bill authorizing be read three times. * Except by vote of majority of voters. ^d Unless authorized by a two-thirds vote at a general election. ^e It is made the duty of the legislature to restrict the powers.
- ^f Unless two-thirds of the voters assent. ^g Unless three-fourths of the voters assent. ^h Refers to counties only, and they may become stockholders, but can not borrow money or incur debt therefor. ⁱ Refers to banking corporations only. ^j Indebtedness for aiding construction of railroads can not exceed 5 per cent of taxable property. ^k State can not undertake internal improvements nor become stockholder in banking institutions. ^l Can not make donation without vote of the people. ^m The restraining provision is under separate sections, superscribed "Municipal subscriptions to railroads," etc. ⁿ Can not engage in works of internal improvements. ^o State can not assume debts of minor civil division, unless incurred for war purposes. ^p Refers to railroad corporations only. ^q Except for educational and charitable purposes. ^r Railroad corporations excepted.

Table showing constitutional provision relating to State and local debts.

STATES.	The credit of the State can not be loaned, or aid given to corporations, etc.			The State can not become a stockholder in any corporation, etc.		
	Constitution.			Constitution.		
	Year.	Article.	Section.	Year.	Article.	Section.
NEW ENGLAND STATES.						
Maine.....	1848	VI	....	....	....	....
New Hampshire.....	....	....	....	....	....	....
Vermont.....	....	....	....	....	....	....
Massachusetts.....	....	....	....	....	....	....
Rhode Island.....	1842	IV	b 18	....	....	....
Connecticut.....	....	....	....	....	....	....
MIDDLE STATES.						
New York.....	1874	VIII	10	....	....	....
New Jersey.....	1844	IV	6	1873	IX	6
Pennsylvania.....	1873	IX	6	1873	IX	6
Delaware.....	....	....	....	....	....	....
Maryland.....	1867	III	34	....	....	....
SOUTHERN STATES.						
Virginia.....	1870	X	12	1870	X	14
West Virginia.....	1872	X	6	1873	X	6
North Carolina.....	1876	II	a 14	....	....	....
South Carolina.....	1873	XVI	..	....	....	....
Georgia.....	1877	VII	5	1877	VII	5
Florida.....	1875	XIII	7	1875	XIII	7
Alabama.....	1875	IV	54	1875	IV	54
Mississippi.....	1868	XII	5	1868	XII	5
Louisiana.....	1879	LVI	....	1879	LVI	....
Texas.....	1876	III	50	....	....	....
Arkansas.....	....	....	....	....	....	....
Kentucky.....	1850	II	33	....	....	....
Tennessee.....	1870	II	31	....	....	....
WESTERN STATES.						
Ohio.....	1851	VIII	4	1851	VIII	4
Illinois.....	1870	IV	20	....	....	....
Indiana.....	1851	XI	12	1851	XI	12
Michigan.....	1860	XIV	6	1860	XIV	8
Wisconsin.....	1848	VIII	8	1848	VIII	p 10
Iowa.....	1867	VII	1	1857	VIII	3
Minnesota.....	1860	IX	10	1857	IX	p 5
Missouri.....	1875	IV	45	....	....	....
Kansas.....	....	....	....	1859	XIII	a 5
Nebraska.....	1875	XII	8	....	XI	8
Colorado.....	1876	XI	1	1876	XI	2
Nevada.....	1864	VIII	a 9	1864	VIII	a 9
Oregon.....	1857	XI	a 8	1857	XI	6
California.....	1879	XII	18	1879	XII	18

Table showing constitutional provision relating to State and local debts—(continued).

STATES.	Minor civil divisions can not loan their credit or grant aid.			Minor civil divisions can not become stockholders, etc.		
	Constitution.			Constitution.		
	Year.	Article.	Section.	Year.	Article.	Section.
NEW ENGLAND STATES.						
Maine.....	1877	II	* 5	1877	II	* 5
New Hampshire.....						
Vermont.....						
Massachusetts.....						
Rhode Island.....						
Connecticut.....	1877	XXV	....	1877	XXV	....
MIDDLE STATES.						
New York.....	1874	VIII	11	1874	VIII	11
New Jersey.....	1875	I	Par. 19	1875	I	Par. 19
Pennsylvania.....	1873	IX	7	1873	IX	7
Delaware.....						
Maryland.....	1867	III	* 54	1867	III	* 54
SOUTHERN STATES.						
Virginia.....						
West Virginia.....						
North Carolina.....	1876	{ II VII	{ 14 7 }	....	....	....
South Carolina.....	1868	IX	* 9			
Georgia.....	1877	VII	6	1877	VII	6
Florida.....	1875	XIII	7	1875	XIII	7
Alabama.....	1875	IV	55	1875	IV	55
Mississippi.....	1868	XII	* 14	1868	XII	* 14
Louisiana.....	1879	LVI	....	1879	LVI	....
Texas.....	1876	III	* 52	1876	III	* 52
Arkansas.....	1874	XII	5	1874	XII	5
Kentucky.....						
Tennessee.....	1870	II	* 29	1870	II	* 29
WESTERN STATES.						
Ohio.....	1851	VIII	6	1851	VIII	6
Illinois.....	1870	*	....	1870	*	....
Indiana.....				1851	X	* 6
Michigan.....	1850	XV	* 13	....	....	....
Wisconsin.....						
Iowa.....				1857	VIII	* 4
Minnesota.....				1879	IX	* 15
Missouri.....	1875	IV	47	1875	IV	47
Kansas.....						
Nebraska.....	1875	XII	* 2	1875	XI	1
Colorado.....	1876	XI	1	1876	XI	2
Nevada.....	1864	VIII	* 10	1864	VIII	* 10
Oregon.....	1857	XI	9	1857	XI	9
California.....	1879	IV	31	....	....	....

In addition to such limitations upon financial powers as have been mentioned, many States make provision in their organic laws for the sure extinction of any debts that may be created. The most simple method of attaining this end is to require, in the law authorizing the loan, the establishment of a tax that can not be repealed until the principal of the debt shall have been expunged. A provision of this sort will be found in the constitution of Nebraska. Colorado adopts the same requirement, but adds that the debts shall be drawn redeemable in ten and payable in fifteen years. Other States require a sinking-fund by which the debts may be extinguished in a specific number of years. New Jersey admits of bonds that shall run for thirty-five years. Kentucky limits any specific debt to thirty years. In California, Nevada, Iowa, Illinois, and West Virginia, it is required that debts shall be paid in twenty years from the date of their creation; in New York the time is eighteen years; in Maryland it is fifteen years. In Minnesota all temporary debts must be expunged in ten years, while in Wisconsin five, and in Missouri but two years are allowed for such obligations. Georgia appropriates \$100,000 to the establishment of a sinking-fund. Ohio requires the establishment of a sinking-fund that shall pay \$100,000 of the principal of her debt each year. Florida demands a tax "sufficient to pay the principal and interest of the existing indebtedness." The constitution of Virginia demands merely the establishment of a sinking-fund. There are some other provisions of this sort applying for the most part to minor civil divisions, but from those which are given it appears that the purpose involved in them all is the same—that is, to make provision for the payment of the debt at the time the debt is created. The wisdom of such a provision has already been discussed in a former part of this essay. For national financing—that is, financiering in the presence of exigencies that may not be forecast—provision for the payment of a debt at the time of its creation was found to lay an unnecessary strain upon the taxing machinery of the government;

but for local financing such stipulations as the above are wholly in harmony with sound methods.

Such in the main are the facts pertaining to the legal restrictions imposed upon the financial powers of local governments, and it becomes now our task to consider the policy which they disclose. We may, however, proceed with greater clearness in this discussion if we first reduce these facts to some orderly statement, so as to discover the principles that underlie them; nor will this be difficult, for a slight consideration shows that they naturally arrange themselves in three distinct classes, according as the power, the occasion, or the method of incurring debts is brought into view.

1. The power to incur debt may be directly limited by law, or indirectly limited by means of restrictions placed upon the legislature to tax for support of debts.

2. The necessity of incurring debt may be taken away by withholding from the legislative body the privilege of entering upon such duties as call for the expenditure of large sums of money, either independently or in connection with private corporations.

3. The method for legalizing the creation of a debt may be more carefully guarded than is the case for ordinary bills. That is to say, the law may require that bills calling for the employment of public credit shall meet the approval of voters, or be assented to by more than a majority of the legislative body, or pass the assembly in such a manner as to attract the especial notice of members.

Let us consider these principles of restriction in the reverse order in which they have been presented.

The general purpose disclosed by legal limitations of the third class meets with the unqualified approval of the science of finance. The danger which always besets popular government in a populous country arises from the fact that the people are separated from those who represent them; and the object of establishing strict rules for the legalization of important bills is to render current legislation clear, and to bring business home to the people. In the early part of this

essay, when considering the political tendencies of public debts, it was said that the custom of borrowing money worked against the full realization of popular government, because legislators could, by use of public credit, cover up their tracks and commit the people to enterprises in which they have no interest. The only safeguard against such an evil is the establishment of strict rules for fiscal legislation. So far as legal restrictions of this sort are concerned, therefore, not only may we approve those that exist, but we may reasonably demand that the principle involved shall be yet further developed.

The restrictions of the second class, so far as they prohibit cities, counties, and towns from loaning their credit to private corporations, must likewise meet with general approval. The reasons against such an employment of municipal credit are the same as those properly urged against the levy of a special tax in favor of private interests, or against the exemption of property from taxation on condition that certain industries will be established in one place rather than another. Consider, for example, this last proposal. The choice of a site for the establishment of a manufactory is of direct interest only to those who deal in real estate. If the new business bring with it an increase in population, it is true that values will increase and rentals rise. But beyond this, for the State at large, or for the people who consume the goods produced, it is of no great importance where the industry is situated. Why, then, should this increased burden (for the exemption of any property from taxation increases the amount that must be paid by other property) be thrown on the community when the benefit accruing therefrom is not enjoyed by all? When, however, the practice prevails of granting immunity from taxation to industries newly established, a corporation with money in hand is in a position to play the coquette with rival towns, and secure for itself privileges of a special nature. In the majority of cases these privileges are a pure gratuity, and the industry is established where the managers had decided to found it before they ap-

proached the towns with their alluring offers. The only remedy for such an evil as this is the establishment of a general rule that shall prohibit all towns from making arbitrary exemptions.

The same line of reasoning applies when railroads ask from minor civil divisions the loan of their credit. We may rest assured that railroad facilities will be furnished when the traffic of a territory offers adequate inducements for such an investment of capital, and the representations of the managers, that without public assistance the roads will not be built, are in large measure false. At least, if such assistance is required, it should be given through the agency of some body that can look after the investment which the public makes, and this can not be done by the minor civil divisions. But so long as it is permitted to vote taxes or bonds for railroad purposes, the managers have it in their power to secure for themselves a favorable exercise of popular suffrage; that is to say, private corporations are enabled to make use of the revenue machinery of the state for private ends. This is certainly an evil, as the existence of township debts and the corruption practiced by means of the bonds of minor civil divisions amply testify. A slower development on a more solid basis should be guaranteed by law.

But these considerations do not apply with equal force to State governments. A State differs from the minor civil divisions in two particulars. It is supposed, in the first place, to hold in view the general welfare of the entire community over which it extends its jurisdiction, and to make progressive and uniform development its especial care. In the second place, it is from the State government that the corporations receive their charters, and they must in consequence conform to State laws in the administration of their affairs. It does not then follow, as in the case of the minor civil divisions, that capital placed at the disposal of corporations passes forever beyond the control of the legislative body that rendered pecuniary assistance. We are dealing here with a government which, according to the theory of our constitution, is

supreme for all local purposes. Suppose it be true, as is so frequently stated (and as the history of inland commerce in the United States goes to show), that private credit is not adequate to the harmonious development of internal resources, it is certainly the States and not the inferior governments created by the States that should take this matter in charge. But, under the present condition of public law, this is impossible. The States are shorn of their most effective instrument of power, in dealing with practical questions of internal administration, by the fact that they can not loan their credit and thus gain a business standing among business enterprises. If such governmental assistance and control as are here intimated continue to be necessary in the future, it is the Federal government and not the State governments that will undertake the task, and we are thus brought back to the old question of the proper distribution of political powers. But the thoughts thus suggested will be brought out more clearly in connection with an analysis of the remaining class of financial restrictions.

What may be said of those laws and constitutional provisions that deprive the States and local governments of the right to borrow money? Here again it appears that there is more reason for imposing financial restrictions upon the minor civil divisions than upon the States; and perhaps nothing can be said against the policy, as applied to the inferior governments, if only the laws admit of a sufficiently wide margin. For the sake of explicitness in our argument, let us first consider this policy as applied to cities. The entire question will, of course, turn upon the ideas entertained respecting the proper functions of municipal government. If men still persist in maintaining the theory of individual sufficiency, and hold to the teachings of *laissez-faire* in matters of city administration, they will certainly regard any proposal that looks to the extension of local duties with distrust. But, as has been shown in the foregoing pages, such a position can not be maintained in the face of industrial and administrative history in the United States, and, if the decay

of municipal government is to be arrested, another policy must be pursued.

But our present argument in favor of granting cities extensive financial powers considers the question of municipal government from another point of view. It is not the corruption of public officials, but the corruption of private corporations imposed with duties of a *quasi* public nature, that now claims attention. None will deny to the municipal government the duty of extending its protection to citizens against all unnecessary burdens from which citizens can not protect themselves; it becomes therefore the duty of municipal authorities to guard citizens against exorbitant charges from private parties intrusted with the performance of duties of a public nature. Or, to put the case plainly, street railways, gas companies, and water companies should not be permitted the liberty of fleecing those who are obliged to have dealings with them. It is, however, a well-established principle in political science that all duties assigned to any department of government should be accompanied with powers adequate to their performance. The question, therefore, as to the wisdom of imposing financial restrictions upon the municipalities reduces itself to this: Can citizens expect adequate protection against private corporations that render services of a public nature if they deny to the municipal governments control over capital?

The facts pertaining to municipal management of gas and water supply are by no means uniform in the United States. I have had occasion to investigate somewhat the methods adopted, and, although this is no place for relating in detail the facts discovered, one or two statements may be of interest as bearing upon the question in hand. There seems to be a more marked inclination on the part of cities to assume direct control over the business of supplying water than over that of furnishing light; and in passing it may be said that the administration of water companies is the occasion of less frequent complaint than that of gas companies. But where private water-works are allowed, their franchises

are likely to be drawn with greater care than in the case of lighting companies. One provision, by no means infrequent, is that water shall be supplied at rates no higher than the rates charged in other cities similarly situated. If one city in the midst of twenty others should adopt such a provision, reserving to itself sufficient power to enforce the contract, the agreement might be regarded as significant; but when each of twenty cities grants to private companies the privilege of establishing water-works on condition that rates charged shall be average rates, it is difficult to see what guarantee of fair treatment the people find in such a clause.

Another method by which it is hoped to maintain control over the management of water companies appears in the right which certain of the smaller towns have reserved of purchasing the property of the water company at pleasure. The administrative principle thus disclosed is one of wide acceptance in European countries. It was adopted by Belgium and France in making concessions for the building of railroads. The manner of its working is quite simple. Assuming the government to be in a condition to carry through a purchase, if the administration of private companies should not be satisfactory, the public has little to fear from private management. The rates charged will probably be equitable, the dividends paid will be but a fair return upon capital actually invested, there will be no consolidated stock and no fictitious bonds, and the public may also expect fair and courteous treatment from the officers of the concern. But it should be held clearly in mind that it is the financial ability of the government to purchase, and not the legal right to purchase, upon which the effectiveness of this guarantee rests. If the directors of a water company know that it is practically impossible for a city to raise money enough to pay the appraised value of their plant, this reserved right of the city becomes a dead letter; the management will listen to neither the complaints of citizens nor the suggestions of municipal officials. From such a line of reasoning we are led to conclude that considerable latitude

should be granted municipal authorities in their control over capital.

It by no means necessarily follows from the foregoing argument that all cities should own and control water-works. Our reasoning extends no further than to declare this fact: Unless cities are actually in a condition to purchase such works, no laws that may be passed will find enforcement against such corporations. It is not denied that regulative laws are of some importance, but it is claimed that they are no final solution of the question involved. Corporations do not greatly fear such laws, for law can not compel the observance of fair business rules. The only practical leverage that a local board has in dealing with a water company or a gas company is the threat that, if its service to the public be not open and just, it will be relieved from the privilege of rendering further service. The business is from its nature a monopoly. No reliance can be had on competition. One gas company is better than a dozen. But this one company should ever be made to feel that its relation to the public is that of an agent to a principal; and in order that the business may be managed in the interest of the principal rather than of the agent, the principal must be in a position to discharge the agent at will. This, however, the municipal authorities can not do unless they are clothed with some power that gives them control over capital.

It remains only to consider the limitations imposed upon the States. These are of two sorts: by the one the State is denied the right of entering upon works of a public nature; by the other it is forbidden to incur debt beyond a specified amount. We need not, however, subject these to a separate consideration, for limitations of the second sort include the first.

That our thought may not be diverted from the main question in hand, it will be well at this point to insert a word of explanation. It may appear from our presentation of the history of local indebtedness, and the history of industrial development with which it is so intimately related, that the

main purpose of our argument was to infuse new life into the old doctrine of States rights. Frequent mention has been made of the encroachment of the Federal government upon the States, as though that were necessarily an evil. It was not, however, intended to bring the old controversy again into prominence, nor can any appreciative student of American history fail to see that the problem here suggested is very different from the one which claimed the attention of Calhoun and Webster. We are here dealing with a question of internal administration, and have nothing to do with the nature of political rights or the maintenance of a theory of sovereignty.

Yet I would not leave the impression that this question of financial restrictions fails to bring into prominence considerations of a political nature, for I believe it to be at bottom nothing less than the question of the maintenance of republican institutions on American soil. A disregard of the fundamental principles of republicanism will defeat the most perfectly written constitution; it bears, therefore, directly on our subject to inquire what these principles may be. They are two. First: All concentration of power, no matter by whom exercised, should be held to strict accountability. Second: The exercise of all responsible power should lie as closely as possible to the people upon whom it is exercised. So long as these principles are maintained, the purpose of constitutional government is safe, and the highest possible liberty for man as a member of society is insured; but disregard them, and republican government will prove a failure.

In view of such a statement of the case, the historical sketch included in Part III of this essay assumes a deep significance. Its immediate purpose was to explain the shifting of indebtedness between the various grades of government, but its result has been to bring into clear light an important phase of social development. It declares that both of the principles laid down as essential to the maintenance of popular liberty have been disregarded. Thus the present standing of private corporations before the law contradicts

the rule that all concentrated power should be exercised under strict accountability. The American people deceive themselves in assuming to think their liberties endangered only by the encroachments of government. The center from which power may be exercised is of slight importance; it is the fact of its irresponsible exercise which may justly occasion apprehension. The growth of private corporations is a step in the development of our social constitution. They arose upon the ruins of the States as centers of industrial administration, and it is because the States have failed to retain a proper control over them that they now menace the permanency of popular government. It is true that about 1873 the right of legal control was judicially affirmed, but, so far as railroads are concerned, the measures adopted by the various legislatures served only to disclose the impotency of the States. These corporations are practically irresponsible to the people by whose favor they exist, and whom they pretend to serve. Popular liberty could be menaced by no greater danger.

On the other hand, the growing importance of the Federal government threatens to disregard the second rule, that responsible power should lie as closely as possible to those upon whom it is exercised. I do not know that the extension of Congressional duties in late years has introduced a tendency unhealthy in itself, for most of the new powers assumed are such as seem essential to the maintenance of unity in national interests or of uniformity in institutions. Few would now deny that the Federal government should control banking and currency. It is perhaps more rational to fear for the future than to deprecate what has already taken place. The public is alive to the necessity of finding some adequate solution to what is properly known as the monopoly question, and should it ever be made clear that this question can not be solved except by extending the administrative function of government, there is little doubt as to the grade of government to which the people will turn for relief. The only center of political power now in a position to assume

such duties is the Federal government. The financial disabilities under which the States rest have placed them *hors de combat*; and, without some radical modification of existing relations between the various centers of government, the pressure of coming events will inevitably lead to an extension of administrative functions under the direct control of Congress. This will be a disregard of the second principle laid down as essential to the maintenance of government by the people; it will result in the complete destruction of the State governments, which ought to be regarded as the stronghold of the Federal as opposed to the Imperial idea.

But there is more to this question than the solution of the railroad problem. It is an historical rule of wide application, that as countries become more populous, and the social and industrial relations more complex, the functions of government must necessarily extend to continually new objects. This rule holds good now and in this country, and, in consequence, the question of the residence of new powers becomes more important year by year. Consider, as a simple illustration, the increasing necessity for care of the forests. The frequent recurrence of floods; the more rapid and marked alternation of drought and wet; the progress of farming toward the exhaustion of lands; all point clearly to the fact that the people of this country must soon turn their attention to the culture of trees. But this is a line of enterprise that individuals will not enter upon, because the returns in dividends are too remote from the first investment. It is a legitimate sphere for the employment of public credit, and the only remaining question is: Shall the enterprise be undertaken by the central government or by the local governments? To my mind there is but one answer. The States are the proper center for the exercise of this function, yet they are in no position to perform this duty. They have been deprived of the facilities for undertaking such a measure by an over-solicitous people, frightened by one unfortunate industrial venture.

Such are the considerations which lead me to regard with

solicitude the next step in the development of the industrial constitution of the United States. If this country continues to drift, it will surely come at last under a government of concentrated political and administrative duties. The danger of the present day lies in the manifest tendency to bring the political idea of sovereignty into industrial affairs. This is an altogether different thought from that which recognizes the necessity of bringing industrial activity into closer relation to government agency. The former leads to State socialism; the latter contemplates only such a modification of the relations between State agency and private activity that the purpose which underlies the doctrine of *laissez-faire* may be realized. New meaning must be infused into the language of the old democratic doctrine of States rights, in order to successfully combat the extension of Imperial ideas. The question of importance pertains to the proper political and financial equipment of the States for the solution of the industrial problems forced upon them by the growth of corporations.¹

We are in some danger, in this extended discussion, of losing sight of the manner in which it was introduced. The point in controversy, it will be remembered, pertains to the wisdom of imposing financial restrictions upon the States, but this is a question properly subordinated to other considerations. The social and political tendencies of the present seem to demand that the commonwealths should be made effective factors in dealing with current problems. These problems, however, are essentially of an industrial character, and it is quite doubtful if they can be satisfactorily solved except the States be granted the liberty of controlling industrial power—that is, capital. This liberty they do not now enjoy under the financial limitations imposed by their constitutions.

But by what steps may the States gain a proper equip-

¹ This has nothing directly to do with the "Labor Problem." That problem pertains to organization within industries, and not to the relation of industries to society at large.

ment for dealing with the problem of industrial monopolies now weighing so heavily upon society? A full answer to this query demands a book; but, restraining our investigation to the financial requirements, we may make quite a definite answer. Three distinct steps must be taken, all of which involve a change in public sentiment, or a reversal of certain decisions that have found record in public law, before the commonwealths will be in a position to think strongly and act efficiently upon such questions as forestry or control over inland commerce.

1. The States must be re-empowered to borrow money. This statement but re-affirms the conclusions of our foregoing argument.

2. The States must abandon their claim to political sovereignty in matters of financial contract. This is necessary because such claims are for them the source of financial weakness, and consequently of administrative inability. A private corporation with unincumbered property can secure money at cheap rates, because the contract into which it enters is amenable to the judgment and enforcement of the courts; but the contract of a State, which is sovereign in character, rests for security upon the good-will of the government. It is this liberty of repudiation that depresses the credit of the States when they demand money in any considerable amounta. It may be objected that the Federal government also is sovereign in matters of contract, and yet its credit is high. This is true, but the sovereignty of the Federal government is different in character and purpose from that of the States. It stands before the world as a nationality. It is intrusted with the power to declare war and to conclude peace. It lives continually in the presence of possible emergencies, which may demand immediate control over large sums of money, and for that reason can not afford to let its credit decline. But the States are not imposed with sovereign duties of the highest order. The idea of nationality does not now attach to them. They have the right to appeal to the central government for protection against invasion or insurrection.

They are not, therefore, under the political necessity of maintaining an unblemished credit. Is not this position into which American public law has drifted absurd and illogical? The States are clothed with unlimited financial powers for purposes of war, yet never have occasion for going to war; but they are deprived of the right to borrow money for industrial purposes, the only object for which they may properly use their credit. And from the above comparison it is easy to see why the Federal government guards jealously its credit, while the States, organized out of identically the same material, show great carelessness respecting it. The truth is that State sovereignty, as it is now maintained, would act as a dead weight upon the credit of the commonwealths should they ever be empowered again to borrow money.

But, assuming the States are willing to abandon the shadow of dignity for the substance of power, how might such a purpose be attained? This might be done, so far as law is concerned, by the repeal of the eleventh amendment to the Federal Constitution. That amendment, as will be remembered, granted the States immunity from suit on complaint of a private person. Its repeal would permit a private creditor to bring a State to the bar of the Federal court. But there is no reason to expect that such a proposal could ever be carried through, for, as the States grow in number, the difficulty of securing amendments to the Federal Constitution continually increases. Nor is it necessary to introduce so radical a change into our organic law. The same end might be attained should each State, in wording its contracts, grant creditors right of suit in its own courts upon protested bonds. It is one of the curious ideas of the American people that it lies beneath the dignity of a political sovereignty to admit of suit by a private person. Prussia knows no such dignity, but comes into court as defendant on occasion of the most trivial claims; and, should such a practice ever become common on the part of the States, there is no reason why local credit might not equal that of the Federal

government. Indeed, under conservative management of local affairs, there is reason to believe that the commonwealths might borrow money on better terms than the Federal government.

3. It would be necessary, in addition to the right of bringing suit, for the States to provide some sure means for the enforcement of a judgment. I will not undertake to discuss this question of legal procedure, but it is quite clear that the principle upon which reliance must be had is, that a court can enforce by mandamus the execution of a law which, duly passed, has become part of a legal contract. This would change the character of a State bond from that of a sovereign contract to that of a promise of a minor civil division.¹

In bringing this discussion to a close, it is only necessary to repeat that the question of restricted financial powers, so far as it pertains to the States, is more than a question of finance. In its discussion I have endeavored to state clearly the terms of the problem with which the country is now called upon to deal, and in that statement my own views have necessarily found expression. I regard the general tendency disclosed by the history of industrial society since 1840, when viewed in its relation to political development and social relations, to have been unfortunate in the extreme. It may have been inevitable, for each step seemed at the time to have been natural and proper. But this tendency has certainly proceeded far enough. The States ought not to be crushed between the expanding powers of the Federal government on the one hand, and the growing importance of private corporations on the other; and the practical question of to-day is how to avoid such a catastrophe. My view of the case may be wrong, but it seems to me that the State governments should be quickly put into such a financial position that they may assume certain administrative duties which the pressure of events is forcing upon governmental agency.

¹ Cf. *ante*, p. 296.

The lessons of the present chapter may be summarized as follows: The problem of municipal government is but one phase of the social problem; the decay of municipal government can only be arrested by a re-arrangement of the privileges, emoluments, and powers offered in the domain of public and private activity, and the reasoning upon which this claim rests is of application to the general discussion pertaining to the efficiency of government of any sort. With regard to financial and industrial limitations, so characteristic of political thought during the last forty years, it seems that the evils against which they were directed were real evils, but that the method of curing them has brought great danger to present society. The restrictions known under the generic term of "budgetary legislation," whose purpose it is to guard the exercise of financial powers, meets with the full approval of the science of finance. The denial of the right to the minor civil divisions to loan their credit to corporations, or to become stockholders in any private business, was likewise adjudged to be a safe and sound policy. But for the States, whether we consider legal restrictions upon the loan of their credit or upon the sale of their credit, we are constrained to withhold our approbation from the theory upon which such restrictions rest.

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